ACTIO INSIGHT

THE EXTRATERRITORIAL APPLICATION OF EUROPEAN COMMISSION'S DRAFT DIRECTIVE ON CORPORTE SUSTAINABILITY DUE DILIGENCE: WHAT DOES IT MEAN TO INDONESIAN COMPANIES?

ANGGRAENI AND Partners

THE EXTRATERRITORIAL APPLICATION OF EUROPEAN COMMISSION'S DRAFT DIRECTIVE ON CORPORTE SUSTAINABILITY DUE DILIGENCE: WHAT DOES IT MEAN TO INDONESIAN COMPANIES?

By Setyawati Fitrianggraeni and Fildza Nabila Avianti[1]

Keywords: Corporate Sustainability Due Diligence Directive, Extraterritorial Application, Indonesian Companies, European Commission, Human Rights, Environmental Impacts.

A Executive Summary

The Council of the EU has adopted its general approach on the corporate sustainability due diligence directive. The next step would be to start negotiations with the European Parliament. If passed, the due diligence directive lays down rules on obligations for large companies regarding actual and potential adverse impacts on human rights and the environment, with respect to their own operations, those of their subsidiaries, and those carried out by their business partners. It also lays down rules on penalties and civil liability for violating those obligations. Lastly, it also lays down obligations for companies to adopt a plan ensuring their business model and strategy are compatible with the Paris Agreement.

Considering the breadth of its scope, the Draft Directive would apply extraterritorially to any non-EU company and its subsidiaries if those group companies have aggregate revenues in the EU of:

a. More than EUR 150 million (Group 1); or

b. More than EUR 40 million, with at least 50% of net worldwide revenues generated in a "high-risk" sector which includes textiles, clothing and footwear, agriculture, forestry, fisheries, food & extractives (Group 2). For these companies, the rules will start to apply two years later than for Group 1.

Notably, the Draft Directive applies to non-EU based companies even if such companies and their subsidiaries do not have a physical presence in the EU, if the above net turnover threshold is met.

In essence, the Draft Directive requires both Group 1 and Group 2 companies to take appropriate measures to:

- Identify
- Mitigate
- Actual and potential adverse human rights and environmental impacts arising from their operations anywhere in the world (not just in the EU, and from their "established business relationships").

B. Background of the regulation

a. Authority of the European Commission

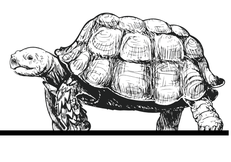
The main role of the European Commission is to promote the general interest of the EU by proposing and enforcing legislation as well as by implementing policies and the EU budget. The Commission has the 'right of initiative', in other words, the Commission alone is responsible for drawing up proposals for new European legislation. These proposals must aim to defend the interests of the Union and its citizens, not those of specific countries or industries. However, it is the Council and Parliament that pass the laws.

b. What does Directive mean?

According to Article 288 of the Treaty on the Functioning of the European Union, the EU Directive is a legislative act that sets out a goal that all EU countries must achieve. However, it is up to the individual countries to devise their own laws on how to reach these goals. Therefore, Directives normally leave EU member states with a certain amount of leeway as to the exact rules to be adopted.

c. The backdrop for issuing the draft directive

The proposed Directive aims to set out a horizontal framework to foster the contribution of businesses operating in the single market towards the achievement of the Union's transition to a climate-neutral and green economy in line with the European Green Deal and the UN Sustainable Development Goals. The Draft Directive affirms that a high level of protection and improvement of the quality of the environment and promoting European core values are among the high priorities of the Union, as set out in the Commission's Communication on A European Green Deal.[2]



THE EXTRATERRITORIAL APPLICATION OF EUROPEAN COMMISSION'S DRAFT DIRECTIVE ON CORPORTE SUSTAINABILITY DUE DILIGENCE: WHAT DOES IT MEAN TO INDONESIAN COMPANIES?

By Setyawati Fitrianggraeni and Fildza Nabila Avianti

d. The current development of the law

The Draft Directive has been presented to the European Parliament and the Council for approval. Once adopted, Member States will have two years to transpose the Directive into national law and communicate the relevant texts to the Commission. In the meantime, companies within the scope of the draft directive should prepare now for the upcoming due diligence obligations by developing or reassessing existing responsible programs and policies and make sure they can comply with the upcoming requirements. This would include auditing their supply chains for practices adverse to human rights and negative environmental impacts of operations, and implementing risk-bases, robust, and effective supply chain due diligence practices to mitigate potential risks before they arise.

C **Key highlights of the regulation**

a. In terms of companies, there are seven key areas that companies will be required to comply with:

i. Due diligence policies. Companies will need to integrate due diligence into their corporate policies and procedure and review them annually. This policy should include a description of the due diligence processes in place across the organization.

ii. Identify adverse impacts. Companies will need to identify actual and potential adverse human rights and environmental impact from their own operations, their subsidiaries, and from established business relationships within the value chain;

iii. Prevent potential impacts. Companies will need to take appropriate measures to prevent or, where prevention is not possible, adequately mitigate potential adverse impacts.

iv. End actual impacts. Companies will need to take appropriate measures to bring an end to actual adverse impacts which are, or should have been, identified through the due diligence process.

v. Complaints procedure. Companies will need to establish and maintain a complaints procedure for people and organizations affected by their adverse impacts.

vi. Monitoring. Companies will need to monitor the effectiveness of the identification, prevention, mitigation, ending, and minimization of adverse impacts through annual assessment, or assessments where there are reasonable grounds of a new risk.

vii. Communicating. Companies will need to publish an annual statement on their website covering the due diligence undertaken, adverse impacts identified, and actions taken in the previous calendar year.

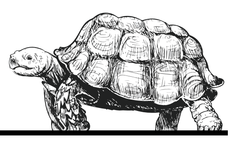
b. For directors, the Draft Directives oblige them to:

i. Consider human rights, climate and environmental consequences of their decisions in acting in the best interests of the company;

ii. Adopt a plan to ensure a company's business model and strategy is compatible with the transaction to a sustainable economy while limiting global warming to 1.5°C, to be in line with Paris Agreement; and

iii. Are responsible for putting in place and overseeing the company's due diligence program, with consideration of germane input from stakeholders and civil society organizations.

It is worth to note that this obligation is more expansive than the existing and anticipated national Draft Directive from Member States.



THE EXTRATERRITORIAL APPLICATION OF EUROPEAN COMMISSION'S DRAFT DIRECTIVE ON CORPORTE SUSTAINABILITY DUE DILIGENCE: WHAT DOES IT MEAN TO INDONESIAN COMPANIES?

By Setyawati Fitrianggraeni and Fildza Nabila Avianti

c. Consequence of non-compliance

Article 20 of the Draft Directive provides that Member States shall enforce sanctions for non-compliance that are "effective, proportionate, and dissuasive".[3]

d. New civil liability regime can encourage higher due diligence

Article 22 of the Draft Directive introduces a new civil liability regime whereby companies will be liable for damages, whether through intentional or negligence, or a failure to comply with the mandated due diligence obligation (identify, mitigate, and end adverse human rights and environmental impacts).[4] The victims of such damage will have the right to full compensation in accordance with national laws. However, it is worth noting that a company cannot be held liable if the damage was caused only by its business partners in its chain of activities.

D What does the regulation mean for Indonesian companies

According to Article 2, the Draft Directive applies to certain large EU and non-EU companies that meet the criteria set out below:

- EU companies which have:
  - More than 500 employees and a net worldwide turnover of more than EUR 150 million; or
  - More than 250 employees and a net worldwide turnover of more than EUR 40 million, provided that at least 50% of this net turnover was generated in a "high-risk" sector (which includes textiles, clothing and footwear, agriculture, forestry, fisheries, food, and extractives).
- Non-EU companies which have:
  - Net turnover of more than EUR 150 million in the EU; or
  - Net turnover of more than EUR 40 million but not more than EUR 150 million, provided that at least 50% of its net worldwide turnover was generated in one of the "high-risk" sectors noted above.

Around 4.000 non-EU companies would fall within the above criteria.[5] It is worth noting that SMEs are excluded from the due diligence obligations in the Draft Directive. The Draft Directive will apply extraterritorially to non-EU companies that meet the above criteria, *even if they do not have a physical presence in the EU. According to Article 15 of the Draft Directive, non-EU companies are also required to appoint an EU-based representative to liaise with EU supervisory authorities*.[6]

E. Bibliography

Laws and Regulations

European Commission, Proposal for a Directive of The European Parliament and of The Council on Corporate Sustainability Due Diligence and Amending Directive (EU) 2019/1937 - General Approach, https://data.consilium.europa.eu/doc/document/ST-15024-2022-REV-1/en/pdf, retrieved on 13 February 2023.

News and Articles

European Union, How the European Union works: Your guide to the EU institutions, https://web.archive.org/web/20120112030418/http://ec.europa.eu/publications/booklets/eu_glance/53/2006-en.pdf, retrieved on 13 February 2023.

European Commission presscorner, Just and sustainable economy: Commission lays down rules for companies to respect human rights and environment in global value chains, https://ec.europa.eu/commission/presscorner/detail/en/ip_22_1145, retrieved on 15 January 2023.

THE EXTRATERRITORIAL APPLICATION OF EUROPEAN COMMISSION'S DRAFT DIRECTIVE ON CORPORTE SUSTAINABILITY DUE DILIGENCE: WHAT DOES IT MEAN TO INDONESIAN COMPANIES?

By Setyawati Fitrianggraeni and Fildza Nabila Avianti

Business and Human Rights, EU Commission Publishes Proposal for a Directive on Corporate Sustainability Due Diligence, https://www.business-humanrights.org/en/latest-news/eu-commission-publishes-proposal-for-a-directive-on-corporate-sustainability-due-diligence/, retrived on 15 January 2023.

Auriga, 41 Indonesian CSOS Joint Statement on EU Due Diligence Regulation, https://auriga.or.id/press_release/detail/41/indonesian-csos-joint-statement-on-eu-due-diligence-regulation, retrieved on 14 January 2023.

Eye on SG, Human Rights and The Environment: What Non-EU based Companies Need To Know Regarding the EU Draft Corporate Sustainability Due Diligence Directive, https://www.eyeonesg.com/2022/05/human-rights-and-the-environment-what-non-eu-based-companies-need-to-know-regarding-the-eu-draft-corporate-sustainability-due-diligence-directive/, retrieved on 14 January 2023.

Mayer Brown, Publications, Human Rights and The Environment What Asia-based Companies Need To Know About The EU Draft Corporate Sustainability Due Diligence Directive, https://www.mayerbrown.com/en/perspectives-events/publications/2022/05/human-rights-and-the-environment-what-asia-based-companies-need-to-know-about-the-eu-draft-corporate-sustainability-due-diligence-directive, retrieved on 14 January 2023.

European Commission, Communication from the Commission to the European Parliament, the European Council, the Council, the European Economic and Social Committee, and the Committee of the Regions, The European Green Deal, https://eur-lex.europa.eu/legal-content/EN/TXT/?qid=1588580774040&uri=CELEX%3A52019DC0640, retrieved on 13 February 2023.

Dr. Johannes Weichbrochdt et al, EU Publishes Draft Corporate Sustainability Due Diligence Directive, Harvard Law School Forum on Corporate Governance, https://corpgov.law.harvard.edu/2022/03/15/eu-publishes-draft-corporate-sustainability-due-diligence-directive/, retrieved on 13 February 2023.

European Commission, Corporate Sustainability Due Diligence, Doing Business in the EU, https://commission.europa.eu/business-economy-euro/doing-business-eu/corporate-sustainability-due-diligence_en#:~:text=On%2023%20February%202022%2C%20the,companies'%20operations%20and%20corporate%20governance., retrieved on 13 February 2023.

ReedSmith, The EU aims to introduce mandatory supply chain due diligence obligations, Perspectives, https://www.reedsmith.com/en/perspectives/2022/11/the-eu-aims-to-introduce-mandatory-supply-chain-due-diligence-obligations, retrieved on 13 February 2023.

---

1. Setyawati Fitrianggraeni is Managing Partner at Anggraeni and Partners, Indonesia, Assistant Professor at the Faculty of Law University of Indonesia, and PhD Candidate at the World Maritime University, Malmo, Sweden and Fildza Nabila Avianti is Research Associate from Ocean-Climate Research Group at Anggraeni and Partners. Writers thanks to Dr. Hary Elias for his time to provide feedback to the article.
2. European Commission, Communication from the Commission to the European Parliament, the European Council, the Council, the European Economic and Social Committee, and the COmmittee of the Regions, The European Green Deal, https://eur-lex.europa.eu/legal-content/EN/TXT/?qid=1588580774040&uri=CELEX%3A52019DC0640, retrieved on 13 February 2023.
3. EU Draft Directive, Ibid.
4. Article 22 of the Draft Directive.
5. Dr. Johannes Weichbrodt et al, EU Publishes Draft Corporate Sustainability Due Diligence Directive, Harvard Law School Forum on Corporate Governance, https://corpgov-.law.harvard.edu/2022/03/15/eu-publishes-draft-corporate-sustainability-due-diligence-directive/, retrieved on 13 February 2023.
6. Article 15 of the Draft Directive.

THE EXTRATERRITORIAL APPLICATION OF EUROPEAN COMMISSION'S DRAFT DIRECTIVE ON CORPORTE SUSTAINABILITY DUE DILIGENCE: WHAT DOES IT MEAN TO INDONESIAN COMPANIES?

By Setyawati Fitrianggraeni and Fildza Nabila Avianti

For further information, please contact:

ANGGRAENI AND Partners

WWW.AP-LAWSOLUTION.COM
P: 6221. 7278 7678, 72795001
H: +62 811 8800 427

S.F. Anggraeni

Managing Partner

fitri@ap-lawsolution.net

Fildza Nabila Avianti

Research Associate
Research Group Ocean - Maritime

fildza.na@ap-lawsolution.net