ESG Due Diligence Update: First lessons from Recent Rulings in the EU

23 August 2024

There has been a major shift in the European Union ("**EU**") in recent years around Environment, Social and Governance ("**ESG**"), from voluntary corporate social responsibility initiatives to a much more regulated and legislation-driven ESG regime. A key component driving this shift is the Corporate Sustainability Due Diligence Directive of June 13, 2024 ("**CS3D**"),[1] which established due diligence requirements for large EU companies and groups,[2] as well as large multinational entities, including those based in the US that are operating in the EU.[3]

The CS3D lays out rules that address (i) due diligence obligations for companies in relation to the adverse ESG impacts of their operations, (ii) liability for companies not complying with these requirements, and (iii) the obligation for companies to adopt and put into effect a transition plan for climate change mitigation.

These regulations are not entirely new to major corporations with EU operations, as similar regulations were enacted in France (the Duty of Vigilance Act)[4] in 2017 and more recently in Germany (Act on Corporate Due Diligence Obligations in Supply Chains)[5] in 2023. Understanding the challenges corporations face in these jurisdictions can be very helpful in anticipating what to expect from the CS3D. To date, the major risks have been potential litigation initiated primarily by NGOs challenging corporation due diligence plans or measures. Managing the potential litigation risk while balancing the ESG standards has placed many corporations' longer term ESG strategies under high scrutiny.

The CS3D is expected to take the due diligence requirements as well as the reputational exposure a step further. In addition to its expanded scope, the CS3D requires EU Member States to designate regulatory bodies and empower them with the authority to both conduct investigations and impose significant financial penalties for corporations who are not in compliance with the new standards. Consequences for companies out of compliance can be up to 5% of the company or group's net worldwide turnover or consolidated turnover.

This new regulatory and legal enforcement approach is likely to increase the potential for reputational harm – certainly something that global corporations are already facing under the pressure of NGO activism. The first French ruling, as well as several of the decisions handed down in the EU, offer valuable insight into the challenges multinational groups operating in the EU will face going forward.

Corporations already under scrutiny

In recent years, the number of cases grounded on the Duty of Vigilance Act has increased in France. This trend, and the expectation that it will continue to grow, has led the Paris Court of Appeals to create a new chamber specializing in "*emerging litigations,*" demonstrating the willingness of the French authorities to take on due diligence matters. This specialized chamber has handed down three decisions to date, on June 18, 2024, in cases where plaintiffs claimed that the defendants breached their obligations under the Duty of Vigilance Act.

Although the court did not rule on the merits in these cases, these decisions reflected that that local impact by global companies on ESG is one of the key subject matters that can be expected to be referred to the courts and regulators under the CS3D.

In each of the three cases submitted to the court, the plaintiffs requested that French multinational groups amend their due diligence plans and take appropriate measures to mitigate the risk associated with their activities abroad. Key points in these cases include:

- In the first case, the parent company of a state-owned French electric utility was put on notice by the plaintiffs relating to a project conducted by a subsidiary specializing in renewable energy production to set up a wind power plant in Mexico. Plaintiffs believe the plant could harm the local population.
- In the second case, a French multinational group that specializes in water and waste management sectors was sued for contaminating the water of a Chilean municipality as a result of a hydrocarbon spill from a drinking water treatment plant.
- In the third case, a French producer and marketer of oil, gas, and renewables has been asked to reduce its net emissions in compliance with the Paris Agreement,[6] to "*put an end to exploration and to the solicitation of new hydrocarbon research permits, and to implement a gradual cessation by 2040 of hydrocarbon exploration and exploitation*."

These cases highlight that companies not upholding their ESG due diligence obligations may be brought before French and other EU courts and authorities. In other words, US companies operating in the EU could face claims and significant financial sanctions for not implementing due diligence pursuant to CS3D, whether or not these operations are conducted in the EU.

Global company activities under stakeholders' scrutiny

In addition to the NGO grievances already raised with regulators, these cases also highlight that due diligence disputes are subject to the intervention of many actors — most of whom can be prone to initiate proceedings related to due diligence regulations. In the three cases submitted to the Paris Court of Appeals, the defendants were each sued by individuals belonging to local communities or NGOs involved in the protection of the environment and human rights, as well as local French cities. Interestingly, the City of New York is also listed a claimant in one the proceedings.

In another case, similar to those noted above, a trade union brought claims against the French national postal company for not having sufficiently included specific risk assessment and mitigating measures in their due diligence plan relating to a number of areas, including harassment, undeclared work, employee

health and safety and illegal subcontracting. In this case, the Union notably challenged illegal employment of workers within a subcontractor of one of the group's subsidiaries.

This diversity of plaintiffs in these matters illustrates the variety of actors to whom companies can be held accountable when it comes to due diligence. Such accountability will be reinforced even more by the CS3D, which requires companies to take appropriate measures around effective engagement with stakeholders. "Stakeholders" is defined fairly broadly and includes "*company's employees, the employees of its subsidiaries, trade unions and workers' representatives, consumers and other individuals, groupings, communities or entities whose rights or interests are or could be affected by the products, services and operations of the company, its subsidiaries and its business partners, including the employees of the company's business partners and their trade unions and workers' representatives, national human rights and environmental institutions, civil society organisations whose purposes include the protection of the environment, and the legitimate representatives of those individuals, groupings, communities or entities*."

The involvement of the stakeholders also appears to be one of the key pillars of ESG regulations in general, serving a similar purpose in the Corporate Sustainability Reporting Directive ("**CSRD**")[7]. In addition, the CSRD, which will be progressively applicable from 2024 onward to 50 000[8] companies operating within EU under certain thresholds,[9] requires companies within its scope to publish a sustainability statement to stakeholders in an accessible, reliable, and comparable format, and must include their sustainability statements.

All these requirements to involve and inform company' stakeholders on the impacts of their activities, as well as the cases submitted to the courts to date, demonstrate that due diligence disputes may rise from local considerations. Companies should pay specific attention to collaborating with their local stakeholders and consider implementing due diligence plans that are effective on a local level.

Liability at stake

Another key issue that has emerged from recent litigation is the admissibility of plaintiffs' claims based on environmental damage, or inadequate measures to mitigate climate change — the first lines of which have begun to be drawn by case law.

In a judgment on April 9, 2024,[10] the European Court of Human Rights ruled specifically on conditions for being recognized as a victim of environmental damage, and stated that "*the applicant must be intensely exposed to the harmful effects of climate change*", that "*there must be an urgent need to ensure the applicant's individual protection, due to the absence of reasonable or adequate measures to mitigate the damage*" and that "*the threshold for meeting these criteria is particularly high.*"

This judgment is also likely to be linked with one of the decisions rendered by the Paris Court of Appeals, in which it declared that certain claims relating to the Paris Agreement that were brough by cities, including the City of New York, were inadmissible because a global climate risk could not be linked to any local damages specifically suffered by them.

If some these claims are declared inadmissible, local authorities will likely have standing to claim damages where specific impacts can be locally identified.

This also extends the scope of requirements for companies subject to due diligence, which may put them in a position of increased accountability, as their liability may be triggered — *in addition* to the sanctions imposed for breach of their obligations.

Takeaways

International companies operating in the EU should consider conducting a compliance assessment as well as a gap analysis to identify and address CS3D risk as soon as possible. Anticipating the potential impacts of the potential ESG regulations on their operations, long-term strategy and compliance programs.

---

[1] Directive EU 2024/1760 of the European Parliament and of the Council of 13 June 2024 on corporate sustainability due diligence and amending Directive (EU) 2019/1937 and Regulation (EU) 2023/2859.

[2] CS3D will apply to EU companies or groups with (a) more than 1,000 employees and a worldwide turnover above €450 million, or (b) a worldwide turnover above €80 million, that entered into franchising or licensing agreements with independent third party in the EU in return for royalties exceeding €22,5 million.

[3] CS3D will apply to non-EU companies or groups operating in the EU with (a) a turnover exceeding €450 million in the EU or, (b) an EU turnover above €80 million, that entered into franchising or licensing agreements with independent third party in the EU in return for royalties exceeding €22,5 million.

[4] *LOI n° 2017-399 relative au devoir de vigilance des sociétés mères et des entreprises donneuses d'ordre*,which came into force on March 27, 2017.

[5] *Gesetz über die unternehmerischen Sorgfaltspflichten in Lieferketten*, which came into force on January 1, 2023.

[6] Paris Agreement to the United Nations Framework Convention on Climate Change, Dec. 12, 2015, T.I.A.S. No. 16-1104, United Nations,Treaty Series,vol. 3156, p.79

[7] Directive EU 2022/2464 of the European Parliament and of the Council of 14 December 2022 amending Regulation (EU) No 537/2014, Directive 2004/109/EC, Directive 2006/43/EC and Directive 2013/34/EU, as regards corporate sustainability reporting.

[8] French Senate information report no. 327 of February 7, 2024 on the implementation of the CSRD directive by undertakings.

[9] The CSRD will be applicable from FY 2024 to public-interest companies or companies issuing securities in the EU Market with an average number of 500 employees, 50 million in turnover and/or €25 million in total assets. From FY 2025, applicable to companies with more than 250 employees and/or €50 million in turnover and/or €25 million in total assets. From FY 2026 applicable to certain small and medium sized enterprises (SMEs) listed on a regulated market in the EU, and small and non-complex credit institutions and captive insurance undertakings.From FY 2028, applicable to companies whose operations are not conducted through EU registered entities or groups (EU turnover exceeding €150 million for each of the last two consecutive financial years and either have at least one EU subsidiary that

qualifies as a large undertaking or a branch that generated net turnover more than €40 million in the preceding financial year.

[10] European Court of Human Rights, Verein KlimaSeniorinnen Schweiz v. Switzerland, no. 53600/20, April 9, 2024 (§§ 487-488)