



CADWALADER
CLIMATE
Connecting Climate Change and the Law

Regulation: European Council Declines to Mandate that Director Care Obligations Require Consideration of Sustainability Matters

December 9, 2022

Regulation



By **Duncan Grieve**

Special Counsel | White Collar Defense and Investigations

In February 2022, the European Commission adopted a proposal for a Corporate Sustainability Due Diligence Directive to “foster sustainable and responsible corporate behavior throughout global value chains.” On December 1, the European Council **adopted** a General Approach regarding the Directive that modified the prior draft in certain respects. In their current form, the rules would require in “scope” companies to undertake due diligence across aspects of their “chain of activities” in order to identify adverse climate and social impacts and implement mitigation efforts. The EC chose “chain of activities” over the original “value chain” language in order to “reflect divergent views of Member States on the issue of whether to cover the whole ‘value chain’ or limit the scope to the ‘supply chain.’”

If adopted, the rules would apply first to EU companies with more than one thousand employees and EUR 300 million net worldwide turnover, or, for non-EU companies, EUR 300 million net turnover generated in the EU three years from enactment of the final Directive. The EC left to the EU Member States, which must individually adopt the Directive, to decide whether “to apply the Directive to the provision of [] financial services.” In another significant change from the Commission proposal, the Council deleted a provision that would have required directors of EU companies to take into account sustainability matters in their decision-making due to concerns from Member States that doing so could “potentially undermin[e] directors’ duty to act in the best interest of the company” and would interfere “with national provisions regarding directors’ duty of care.” The Directive was “aligned as much as possible with the soon-to-be-adopted Corporate Sustainability Reporting Directive (CSRD).”

Taking the Temperature: Notwithstanding the EC decision, the European Parliament has yet to weigh in with its position, and ultimately, Member States will have to decide whether to adopt the Directive in whole or as modified. While significant press attention has been paid to the EC decision to let Member States potentially exempt large aspects

of the financial services industry from the regulation, it also is worth considering the implications, if any, of the EC decision not to mandate sustainability as part of the directors' duty of care. On the one hand, from an "outside-in" materiality perspective, sustainability considerations likely already factor into board decision-making to the extent the issue is material to the organization. And directors of EU companies are subject to various laws and regulations that impact climate-related disclosure and governance, including the CSRD. On the other hand, at least in the abstract, it is possible to imagine situations where director duties to act in the best interest of the company arguably are at odds with considering the company's external impacts. As a result, the choice to defer to Member States' governance codes, or directors themselves, on that issue, appears reasonable and prudent, particularly given the extensive climate regulatory regime already in place.