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CHALLENGES FOR E COMPANIES IN THE REGION ARISING FROM THE PROPOSAL OF THE EU DIRECTIVE ON CORPORATE SUSTAINABILITY DUE DILIGENCE²

Abstract: *Considering that the connection between business and human rights is getting stronger, the Proposal of the EU Directive on Corporate Sustainability Due Diligence is an expected step toward increasing the commitment, protection, respect, and promotion of human rights in business. The Directive is expected to unify the multitude of already existing domestic laws and international standards into a more coherent standard, equal to all stakeholders. Considering that companies are the driving force in building a sustainable economy in society, their contribution to the protection of human rights and the environment is extremely important. The proposed Directive will actually create the obligation for depth analysis and sustainable business in a way that will aim to identify, prevent, and remediate the negative effects of the activities of businesses on human rights and the environment. This paper presents the current situation in the region regarding the level of priority that companies actually attribute to the protection of human rights and the environment, and assesses their readiness to accept these international standards. The author identifies the challenges that may be encountered by companies and propose ways to minimize the possible negative consequences that may occur in the process of implementing the upcoming Corporate Sustainability Due Diligence Directive.*

Keywords: *company law, EU law, harmonization, business, human rights, environment, sustainable development, corporate responsibility.*

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1. Introduction: Business and Human Rights

In today's modern society, there is a widespread consensus that businesses have a duty to uphold and respect human rights. This is especially so considering the fact that today's modern corporations are not defined as an ordinary association of individuals who engage in commerce and aim to make a profit; instead, they have evolved into supranational entities that have a significant impact on the global economy (Real Business Rescue, 2023).³ The increasingly central role that corporations have in global trade leads to the increase of corporate power, both political and social, as well as economic (Bauman, Nolan, 2016: 24). Hence, corporations have enormous potential to influence human rights, either in a positive or negative sense (Newton, 2019:153). In any case, they benefit from the respect for human rights because, otherwise, their non-respect can irreparably damage their financial situation, which in the long run affects the survival of the company in general. Therefore, human rights are undoubtedly an issue that should be considered by all businesses, regardless of their size, activity, headquarters, ownership or structure.

However, the risks that any company may face in this regard will depend, among other things, on the complexity of its supply chain, the country or countries in which it operates, and the nature of its business. As supply chains become increasingly complex and as corporations enter more and more emerging markets, transitional democracies, deficiencies in certain states or in coordination between states in regulating this sphere become more and more apparent (Newton, 2019: 5). Considering that some corporations establish networks of corporate entities operating across different countries in the form of transnational corporate networks, it is certain that (for the purposes of the law) each entity has a separate legal personality. It means that each separate legal entity (including the principle of limited liability) protects the parent company from legal liability in the event that a business entity from the established network causes a violation of human rights. If we take into account the abovementioned in the section of the relevant regulatory framework, the transnational corporate group or network as a whole is not effectively regulated by international law (Bijlmakers, 2018: 46). Therefore, multinational companies can take advantage of different national systems and simply avoid liability by establishing complex chains of subsidiaries that are subject to different legal regimes (Palombo, 2019: 42). Thus, business and human rights, including environmental protection, become a field for which there is an increasing need; thus, there is a growing interest in its regulation through legal and uniform judicial practice.

³Real Business Rescue (2023). Companies that are worth more than countries; Retrieved 17.06.2023 from <https://www.realbusinessrescue.co.uk/advice-hub/companies-worth-more-than-countries>

2. Relevant Regulatory Framework

Regarding regulation, it is important to point out that international human rights instruments primarily oblige states, rather than businesses or organizations, to ensure the protection of individual human rights of persons within their jurisdiction (Newton, 2019:4). On the other hand, states have an obligation to regulate the conduct of corporations within their territory or jurisdiction in case their conduct adversely affects human rights. States attempt to meet these obligations in a number of ways, by enacting and enforcing domestic legislation, providing legal remedies to stakeholders, and imposing regulations and requirements on businesses. This division of responsibility between states and corporations may work well in theory but it often does not lead to successful application in practice as the supply chains of transnational corporations spread further and further, involving many more suppliers from faraway places and across multiple jurisdictions which are obviously difficult to control (Newton, 2019: 4). This leads to a significant gap between the obligations of states under international human rights law and the obligation of businesses operating in those territories. In the absence of domestic legislation, soft law mechanisms attempt to bridge this gap by establishing standards that companies must adhere to regardless of where they operate.

Given that in recent years there has been an accelerated trend toward recognizing the role that businesses play in fulfilling their human rights obligations, human rights obligations are also beginning to extend to the activities of corporations outside the territory. Consequently, there has been a significant increase in legislative action in the sphere of business and human rights both domestically and internationally. Thus, at the international level, human rights are enshrined in international agreements while, at the national level, many countries have implemented their international human rights obligations in domestic legislation (Newton, 2019: 3).

If we refer to the relevant regulations, it is inevitable to indicate the Universal Declaration of Human Rights (UDHR), adopted in 1948,⁴ and two international human rights treaties: the International Covenant on Civil and Political Rights (ICCPR)⁵ and the International Covenant on Economic, Social and Cultural Rights (ICESCR),⁶ jointly, they are often referred to as the “Interna-

⁴UN Universal Declaration of Human Rights (1948), <https://www.un.org/en/about-us/universal-declaration-of-human-rights>, accessed on 29.07.2023

⁵UN International Covenant on Civil and Political Rights (1966), <https://www.ohchr.org/en/instruments-mechanisms/instruments/international-covenant-civil-and-political-rights>; accessed on 20.06.2023

⁶UN International Covenant on Economic, Social and Cultural Rights (1966), <https://www.>

tional Bill of Human Rights”.⁷ Under the ICCPR, member states must, *inter alia*, prohibit slavery/forced labour (Art. 8 ICCPR) and enshrine the right to freedom of association (Art. 22 ICCPR), but the treaty does not oblige companies domiciled within states. The ICESCR, which sets out fundamental economic, social and cultural rights, regulates rights as work (Art. 6 ICESCR), just and favorable working conditions (Art. 7), the right to form/join trade unions and the right to strike (Art. 8), as well as the right to an adequate living standard (Art. 11), the right to the highest attainable standards of physical and mental health (Art. 12), the right to education (Art. 13), and the right to enjoyment of the benefits of cultural freedom and scientific progress (Art. 14 ICESCR). Beyond the aforesaid general human rights instruments, there is a wide range of instruments which addresses specific issues relevant to businesses across various topics. These include conventions brought by the International Labor Organization (ILO)⁸, which are relevant to regulating labor relations as an important area for commercial human rights compliance: the International Convention on the Protection of the Rights of All Migrant Workers and Members of their Families⁹, the Convention on the Elimination of All Forms of Discrimination against Women (CEDAW)¹⁰, and many more.

As for the European Court of Human Rights (ECtHR), it also protects human rights violations by states, not directly by businesses. The European Court of Justice (ECJ) does not have jurisdiction *ratione personae* over complaints brought against individuals or companies. However, the ECtHR regularly demonstrates (through its case law) the failure of states to prevent the violation of human rights by corporations and, in this context, the ECtHR identifies the obligation to regulate that sphere.¹¹

ohchr.org/en/instruments-mechanisms/instruments/international-covenant-economic-social-and-cultural-rights; accessed on 29.07.2023

⁷ UN (1996) International Bill of Human Rights, *A brief history, and the two International Covenants*, <https://www.ohchr.org/en/what-are-human-rights/international-bill-human-rights>; accessed on 20.06.2023

⁸ International Labor Organization, <https://www.ilo.org/global/lang-en/index.htm>; (accessed on 29.07.2023)

⁹ UN International Convention on the Protection of the Rights of All Migrant Workers and Members of Their Families (1990), <https://www.ohchr.org/en/instruments-mechanisms/instruments/international-convention-protection-rights-all-migrant-workers>; (accessed on 29.07.2023)

¹⁰ UN Convention on the Elimination of All Forms of Discrimination against Women (1979), <https://www.ohchr.org/en/instruments-mechanisms/instruments/convention-elimination-all-forms-discrimination-against-women> (accessed on 18.05.2023)

¹¹ See: ECtHR Case Appl.no. 55723/00 *Fadeyeva v. Russia* [2005], and ECtHR Case Appl.no. 16798/90 *Lopez Ostra v. Spain* [1994].

In terms of the subject matter of this paper, the most significant instruments are the UN Guiding Principles on Business and Human Rights (UNGPs)¹², endorsed in 2011 by the UN Human Rights Council, which are a solid roadmap for determining corporations' human rights responsibilities. The UNGPs are built upon three pillars: 'the Protect, Respect and Remedy Framework'. This implies: a) the State's duty to protect against human rights abuses by third parties, (including businesses, and to provide appropriate policies, regulation, and adjudication; b) the corporate responsibility to respect human rights, which means to act with due diligence to avoid infringing on the rights of others, and to address adverse impacts that occur; and c) greater access to effective judicial and non-judicial remedies for victims. The three pillars reflect the different components of a dynamic system of preventative and remedial measures (Bijlmakers, 2018: 54). Therefore, the UNGPs are a guide to how businesses can act in a way that respects human rights. They are soft law, a non-binding mechanism, but despite their 'soft law' nature, the widespread acceptance and adoption of the UNGP by states and businesses as a globally recognized benchmark for business on human rights should not be underestimated.¹³ Therefore, the UN Guiding Principles are one of the most advanced legal instruments available to the victims of human rights abuses by multinational companies because they detail the obligations of states and companies towards stakeholders. Since 2014, the UN Human Rights Council Convention on Business and Human Rights has been under negotiation, the third draft of which was published in 2021.¹⁴ This Convention aims to ensure mandatory due diligence for human rights at the international level, strengthen the mechanisms for redressing victims, and place the UNGP on a firmer legislative footing. This is indicative of the global trend to replace "soft law" by "hard law" instruments governing the activities of private enterprise in respect of human rights. Regardless of the fact that there is still no positive outcome, the negotiations as such signal the degree of interest globally in regulating business conduct with respect to human rights.

¹² UN (2011): Guiding Principles on Business and Human Rights: Implementing the UN 'Protect, Respect and Remedy' Framework", Retrieved 19.07.2023 from https://www.ohchr.org/sites/default/files/documents/publications/guidingprinciplesbusinesshr_en.pdf

¹³ See: Case C/09/571932 *Milieudefensie et al. v Royal Dutch Shell*, HA ZA 19-379 [2021], and Case *Kaliña and Lokono Peoples v Suriname* [2015], IACHR

¹⁴ Third Revised Draft of a proposed binding treaty on business and human rights (17.08.2021), retrieved 29.07.2023 <https://www.ohchr.org/sites/default/files/Documents/HRBodies/HRCouncil/WGTransCorp/Session6/LBI3rdDRAFT.pdf>

The OECD Guidelines for Multinational Enterprises (2011)¹⁵ are another key soft law mechanism. First adopted in 1976, the OECD Guidelines are recommendations for multinational enterprises (MNEs) on responsible business conduct. While the OECD Guidelines are not legally binding on companies, they are binding on signatory governments, which are required to ensure that the Guidelines are implemented and observed. Governments adhering to the Guidelines are required to establish a National Contact Point (NCP) whose main role is to promote the effectiveness of the OECD Guidelines by undertaking promotional activities, dealing with and contributing to the resolution of issues that may arise from alleged non-compliance with the instructions in specific cases (OECD, 2023).¹⁶ Overall, the OECD Guidelines constitute an important tool for civil society to engage with multinational companies and expose malpractice in a mediated quasi-legal setting.

It can be concluded that the existing soft law instruments are an attempt by the international community to recognize the role of multinational enterprises. However, the main problem with soft legal frameworks is that they do not provide any enforceable mechanism against multinational enterprises which could violate certain human rights. They do not go beyond requiring companies to acknowledge that they have human rights responsibilities. Accordingly, the soft law framework is unable to hold accountable those companies that are unwilling to voluntarily acknowledge their responsibility to potential victims. Given the current state of the law and its inability to deal with the responsibility of multinational enterprises that abuse human rights, it is believed that the right approach to multinational companies is to persuade them to behave responsibly towards the communities they affect.

3. Overview of the Directive Proposal on Corporate Due Diligence

In the context of the above, the upcoming Directive on corporate sustainability due diligence - draft EU Corporate Sustainability Due Diligence Directive (CSDDD)¹⁷ is expected to bring together these regulations into a more coherent, region-wide standard. The European Commission adopted a proposal for a Directive on 23 February 2022. The purpose of this Directive is to

¹⁵ OECD (2011). OECD Guidelines for Multinational Enterprises; retrieved 20.05.2023 from <https://www.oecd.org/daf/inv/mne/48004323.pdf>

¹⁶ OECD (2023). National Contact Points for the OECD Guidelines for Multinational Enterprises, <https://www.oecd.org/investment/mne/ncps.htm>, accessed on 20.05.2023

¹⁷ European Commission/EC (2022a). Proposal for a Directive on Corporate Sustainability Due Diligence and Annex, EC, 23 February 2022; https://commission.europa.eu/publications/proposal-directive-corporate-sustainability-due-diligence-and-annex_en; (accessed on 29.07.2023)

encourage sustainable and responsible corporate behavior and to establish human rights and environmental considerations in company operations and corporate governance. The new rules will ensure that businesses address adverse impacts of their actions, including their value chains inside and outside Europe.¹⁸ The need for the Directive arises from the fact that many companies lack clear guidelines and standards for conducting sustainability due diligence, leading to inconsistent practices and gaps in identifying and addressing human rights violations. The proposed Directive aims to fill these gaps and ensure that all companies operating within the EU follow a standardized approach to sustainability due diligence.¹⁹ Indeed, the first central issue is the spatial applicability of the (forthcoming) EU instrument so that it effectively covers (harmful) transnational conduct of multinational companies, incorporated in the Union or active in the EU market (Article 2 **CSDDD**);²⁰ another major issue concerns remedies for the damage caused to victims and to the environment by companies through their supply chain (Articles 7-9 **CSDDD**). In the present case, it means that the mother or ordering company located in the Union may be sued by any victims for compensation of losses suffered in a third country. As for the companies' support for the adoption of this Directive, it is important to note that many large businesses gave public statements and endorsements in support of mandatory human rights and environmental due diligence.²¹ Regarding the latest developments related to the proposal for the Directive, the European Parliament plenary session adopted its proposed amendments to the **CSDDD** on 1 June 2023.²² The EP's proposed amendments constitute the EP's position in the upcoming "trilogue" negotiations with the Council of the EU and the European Commission.

¹⁸ EC (2022b). *Fostering sustainability in corporate governance and management systems*, accessed on 19.07.2023 https://commission.europa.eu/business-economy-euro/doing-business-eu/corporate-sustainability-due-diligence_en

¹⁹ EC (2022c). *Explanatory memorandum on the Proposal for a Directive on Corporate Sustainability Due Diligence*, <https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A52022PC0071> (accessed 29.07.2023).

²⁰ Article 2 §1 and §2 of the Corporate Sustainability Due Diligence Directive and its proposed amendments.

²¹ See: Business and Human Rights Resource Centre, *Companies and Investors in Support of mHREDD*, <https://www.business-humanrights.org/en/big-issues/mandatory-due-diligence/companies-investors-in-support-of-mhrdd/> (accessed on 29.07.2023).

²² See: European Parliament (2023). *Amendments to Corporate Sustainability Due Diligence Directive*, https://www.europarl.europa.eu/doceo/document/TA-9-2023-0209_EN.html (accessed on 25.08.2023)

The Directive would require both EU and non-EU companies operating within the EU to take responsibility for their environmental and social impact, as well as the impact of their suppliers. The Directive would impose an obligation on companies based and operating in the EU to prevent possible risks posed by their activities to human rights and the environment, both in Europe and abroad (Article 2 **CSDDD**). However, this Directive is not binding on all companies. From the proposal's details, the Directive is currently set to affect EU incorporated companies with up to 250 employees average, with a net turnover of more than €40 million within the last financial year or up to 50 employees average, with a net turnover of more than €8 million in the last financial year, if at least 50 percent of this was generated in a high-impact sector. Such high-risk sectors include *inter alia* textiles, clothing, leather (including footwear), mineral extraction, agriculture, forestry, fishing or metal manufacturing. Concerning Non-European companies, this Directive would be binding for companies with a net turnover of more than €40 million generated within the EU in the last financial year or a net turnover of more than €8 million (but not more than €40 million) generated within the EU, provided that at least 50% of its net worldwide turnover was generated in one high-risk sector (Article 2 **CSDDD**). In order to fulfill the obligation of due diligence for sustainable business, companies must exercise due diligence in identifying and preventing environmental and human rights risks. This includes assessing the potential impact of their operations and their supply chains on the environment and human rights (Article 6 **CSDDD**). Companies must take steps to mitigate any risks identified during due diligence. This may include developing and implementing policies and procedures to address identified risks, as well as engaging with suppliers to address any issues if they arise (Article 7 **CSDDD**). Companies must be transparent about their due diligence processes and publicly report their efforts to address environmental and human rights risks. This may include publishing an annual sustainability report or making information available on their websites (Article 11 **CSDDD**). Companies must have functional reporting channels for workers and stakeholders to raise concerns, as well as processes to address them and pursue a follow-up. This may include setting up an email address to report risks, as well as an appropriate follow-up on the complaint (Article 9 **CSDDD**).

4. Corporate Social responsibility (CSR) in the Western Balkans (WB)

The countries of the Western Balkans share similar environmental, economic and social constraints when faced with the challenge of the UN Sustainable Development Goals (SDGs).²³ Given that jurisdictions in the region

²³ See: UN Sustainable Development Goals (2015), <https://sdgs.un.org/goals>

face constant pressure to harmonize their respective legislation with EU law and the fact that the Corporate Sustainability Due Diligence Directive (**CSDDD**) extends to non-EU countries, there is a need to examine how the standards discussed above will be implemented in the jurisdictions of the region. While the proposed Directive has not yet been adopted, companies in the region should begin to consider the potential challenges that could arise if it is implemented. Carrying out the necessary due diligence processes and ensuring compliance with the Directive will require significant resources and time. Many companies in the region may not have the necessary financial or human resources to comply with the Directive and/or have complex supply chains involving multiple countries and suppliers. Conducting due diligence on all of these entities can be challenging and time-consuming, especially if the information is not readily available and/or companies may not have access to the necessary information to conduct due diligence on their suppliers and business partners. Furthermore, the proposed Directive will increase potential liability for companies that fail to identify and address environmental and human rights risks. In that sense, companies could face legal action, fines and damage to their reputation if found to be non-compliant. As a result, companies that are unable to comply with the Directive may be at a competitive disadvantage compared to those that can demonstrate their sustainability credentials. This can affect their ability to attract customers, investors and partners. From the above, it can be concluded that countries may face compliance costs, supply chain complexity, limited access to information, increased liability and competitive disadvantage.

Considering the high levels of unemployment in the region of the Western Balkans, attracting foreign investments is a priority as a matter of state policy, due to its contribution to regional development. As the Western Balkans gradually becomes an alternative location for firms to base their commercial operations, there is a proportionately wider pool of foreign direct investment for regional states and firms to compete with. At the same time, it should be emphasized that these countries, as future EU members, are in different stages of their integration into the EU, and it is this integration that creates a favorable environment for investments and relocation of production locations. But, attracting investments is increasingly linked to respect for human rights and environmental standards (Nechev, Kirchner, 2021: 15). Thus, regional firms will benefit from incorporating the business agenda and human rights into their operations in order to continue attracting foreign investment. In any case, adapting to these standards is a process that is inevitable and any delay is harmful to business, especially considering that

any entity that carries out or aims to carry out business cooperation with business enterprises based in the EU will be exposed to increased scrutiny of its human rights and sustainable development practices. Failure to adhere to them can lead to public scandals and challenges that are unacceptable and should be overcome.²⁴

Investors are increasingly strict about non-compliance by firms that receive investments. Investor exclusion lists have been published, with potentially significant reputational issues for firms.²⁵ Despite these negative examples, it is important to note that the policies of several major investors in the region (e.g. Michelin, Henkel, Coca Cola)²⁶ seem to present good practices for human rights standards in terms of identifying and addressing human rights challenges. Their presence in the Western Balkans opens up space for a wider integration and implementation of human rights and environmental standards in the entire region.

5. Conclusion

The proposed EU Corporate Sustainability Due Diligence Directive presents several challenges for companies in the region. While the Directive has not yet been adopted, companies covered by this Directive should start thinking about how they can prepare for its potential implementation. This may include investing in new resources and processes to ensure compliance, as well as building stronger relationships with suppliers and business partners to ensure access to necessary information. It is extremely important to follow good examples and practices from corporations that treat human rights as an important legal and strategic issue for their business and, as such, integrate its management throughout the core functions of the organization.

²⁴ Such an example is the case of the shoe factory located in the region which was accused of poor and exploitative working conditions, denial of labour rights and a non-payment of minimum wages. See: Business and Human Rights Resource Center/B&HR RC (2016). Reports allege poor working conditions in shoe supply chains in Eastern Europe, 17 Jul 2016; <https://www.business-humanrights.org/en/latest-news/reports-allege-poor-working-conditions-in-shoe-supply-chains-in-eastern-europe-company-responses-included/> (accessed on 20.07.2023).

²⁵ See: Aegon Nederland N.V. (2022). *Responsible Investing Exclusion List* (1 April 2022); Retrieved 06.07.2023 <https://www.aegon.nl/sites/default/files/2022-06/Aegon%20NL%20-%20RI%20Policy%20-%20vd3%20%28clean%29.pdf>

²⁶ See: Michelin (2023). *Respect Human Rights*, <https://www.michelin.com/en/%20sustainable-development-mobility/for-people/respecting-human-rights/>; Henkel (2023). *Human Rights and Social Standards*, <https://www.henkel.com/sustainability/positions/human-rights>; Coca Cola Co. (2023). *Human Rights Standards*, <https://www.cocacola.com/policies-and-practices/human-rights-principles> (accessed on 29.07.2023).

Finally, for any corporation to successfully embed human rights throughout its organization, it is essential that its management and board understand its importance and support it. Through greater education, training and awareness, executives at all levels and in all functional areas can undoubtedly better understand the business of human rights.

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ИЗАЗОВИ ЗА КОМПАНИЈЕ У РЕГИОНУ КОЈИ ПРОИЗИЛАЗЕ ИЗ ПРЕДЛОГА ДИРЕКТИВЕ ЕУ О ДУЖНОЈ ПАЖЊИ ЗА ОДРЖИВО ПОСЛОВАЊЕ

Резиме

С обзиром да је веза између пословања и људских права све јача, предлог Директиве ЕУ о дужној пажњи за одрживо пословање (EU Corporate Sustainability Due Diligence Directive) представља корак ка обезбеђивању дужне пажње и посвећености заштити, поштовању и унапређењу људских права у пословном окружењу. Очекује се да ће Директива објединити многе већ постојеће националне законе и међународне стандарде у кохерентнији међународни стандард, који ће се једнако примењивати на све актере. С обзиром на то да су компаније покретачка снага у изградњи одрживе економије у друштву, њихов допринос заштити људских права и животне средине је изузетно важан. Предложена Директива ће заправо обавезати компаније да спроведу подробну анализу одрживости свог пословања у циљу утврђивања, спречавања и санирања негативних ефеката њихових пословних подухвата на људска права и животну средину.

У раду се даје приказ постојећег стања у погледу приоритета које компаније у региону имају у заштити људских права и животне средине, и разматра њихова спремност да прихвате ове међународне стандарде. Ауторка идентификује изазове са којима се компаније могу суочити у том процесу и предлаже решења за смањивање негативних последица које могу се јавити у процес примене ЕУ Директиве о дужној пажњи за одрживо пословање.

Кључне речи: компанијско право, право ЕУ, хармонизација, одрживо пословање, људска права, животна средина, одрживи развој, корпоративна одговорност.