Briefing: Due diligence in supply chains and net zero plans

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How did we get here?

1. European Parliament resolution of 10 March 2021 with recommendations to the Commission on corporate due diligence and corporate accountability

2. European Commission, *Study on directors' duties and sustainable corporate governance,* July 2020 (Ernst and Young Report)

3. European Commission, *Consultation Document Proposal for an Initiative on Sustainable Corporate Governance* (October 2020)

4. European Commission, Proposal for a Directive on Corporate Sustainability Due Diligence (February 2022)

I. SCOPE

What is sustainability?

Breach of international standards relating to (a) environmental harm or (b) the protection of human rights (Art 3(b)(c) and Annex) “Good governance” gone.

Overall goal is to make legally binding on companies international conventions which traditionally have operated only between and among states. (cf UN General Assembly, Human Rights Council, Working Party on a Legally Binding Instrument to Regulate, in International Human Rights Law, the Activities of Transnational Corporations and other Business Enterprises, Third Revised Draft, August 2021)

Reference now to specific provisions of the listed conventions rather than conventions as a whole.

Still a long list: 20 HR and 12 Env standards. And the former approach not wholly discarded: “Violation of a prohibition or right not covered by points 1 to 20 above but included in the human rights agreements listed in Section 2 of this Part, which directly impairs a legal interest protected in those agreements . . .” Section 2 lists 22 Conventions without specifying particular provisions. (Point 21 of Section 1 of Part I of the Annex)

Which companies are covered? (Art 2)

	Incorporated in EU	Incorporated in Third Country
General Rule	500 ees + €150m turnover world-wide	€150m EU
“High Risk Sectors”	250 ees + €40m ww (50% high risk)	€40m EU (50% of ww turnover high risk
Estimated coverage	13k companies	4k companies

One aim of the differing criteria for EU and TC companies is to “ensure that third country companies are not more likely to fall within the scope” (Draft Directive p 15).

Why companies, not groups?

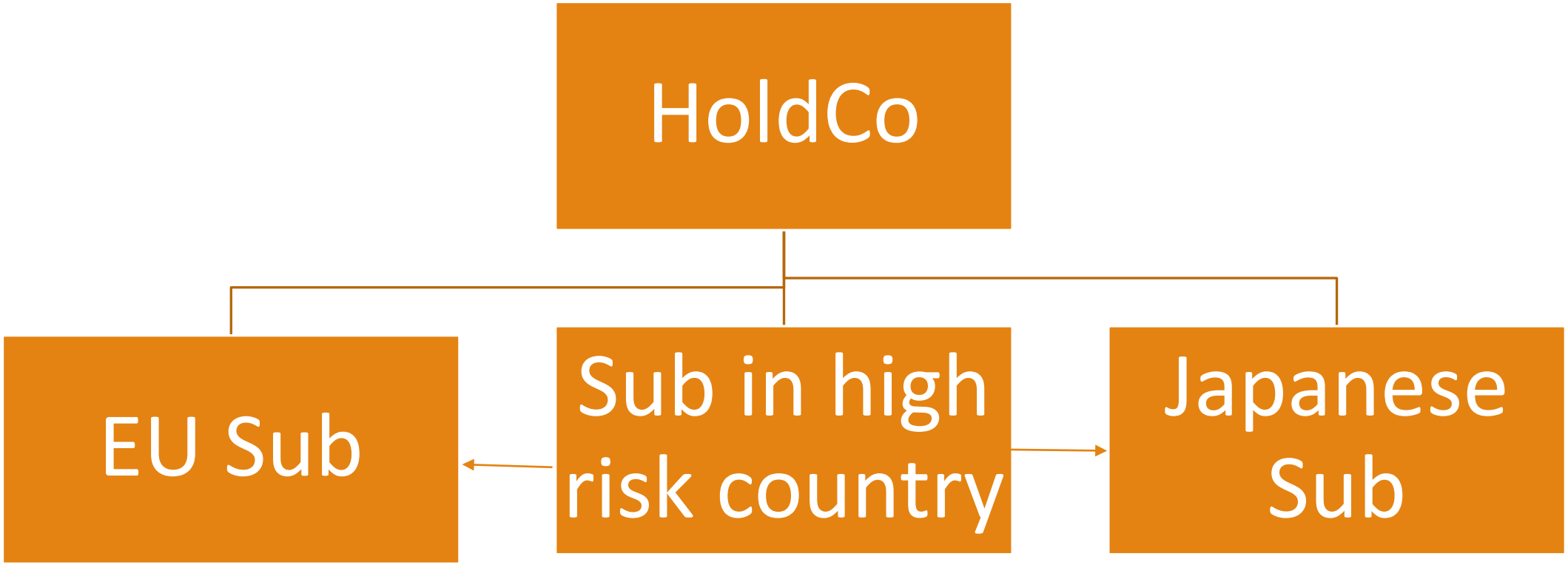
Company-by-company approach does not map onto economic realities of multinational group organisation (in most cases)

Creates possibilities for supervisory complexity and opportunistic behaviour

But, reduces the risk of extra-territorial impact.

Which, however, is not eliminated (see later)

Simple illustration



SUBSTANCE

The “Value Chain”

‘value chain’ means activities related to the production of goods or the provision of services by a company, including the development of the product or the service and the use and disposal of the product as well as the related activities of upstream and downstream established business relationships of the company. (Art 3(g))

‘business relationship’ means a relationship with a contractor, subcontractor or any other legal entities (‘partner’) (i) with whom the company has a commercial agreement . . . or (ii) that performs business operations related to the products or services of the company for or on behalf of the company (Art 3(e))

‘established business relationship’ means a business relationship, whether direct or indirect, which is, or which is expected to be lasting, in view of its intensity or duration and which does not represent a negligible or merely ancillary part of the value chain” (Art 3(f))

What the proposal requires of companies

1. Development of an overarching due diligence policy, which must include a code of conduct to guide internal decision-making (Art 5)

2. “Take appropriate measures” to identify actual and potential adverse impacts arising from breaches of the international standards (Art 6). Companies to consult “where relevant” with stakeholders for the purpose of gathering information on adverse impacts. Not a continuing obligation in relation to financial services. Only “severe” adverse impacts to be identified by companies within scope by virtue of being in high risk sectors (Art 3(l)).

3. “Take appropriate measures” to prevent or “adequately” mitigate potential adverse impacts identified or which should have been identified under Art. 6. Ultimately exit. (Art 7)

4. “Take appropriate measures” to bring actual adverse impacts to an end or to minimise them. This may involve the payment of damages or financial compensation. Ultimately exit. (Art 8)

5. [Special combatting climate change duty: Art 15]

Monitoring

1. Companies to monitor at least yearly the effectiveness of the steps taken under Arts 6-9 (Art 10)

2. Companies to establish “complaints procedure” for use by persons likely to be affected by adverse impacts, employee representatives and NGOs with “legitimate concerns”. Procedure must include elements for dealing with complaints the company considers to be unfounded. (Art 9)

3. If not already required to do so, companies to report annually on their actions under Arts 6-9. Content of reporting to be specified in Commission delegated legislation. (Art 11)

4. Each MS to establish a supervisory authority to oversee compliance with Arts 6-11 by companies incorporated in its jurisdiction. For third country companies the relevant MS is the one where the company has a branch. (Art 17). “Network” of supervisors to be established (Art 21).

Supervisory powers and enforcement

1. Any person entitled to submit a “substantiated concern” to the supervisory authority of non-compliance with the national implementing measures (with right of review if supervisory authority does not think the concern worth following up). (Art 19)

2. Whether on its own motion or in response to a complaint supervisory authority may request information from the company or institute an inspection (Art 18)

3. If action under 2 reveals a breach of the national provisions, authority may (i) order a cessation, (ii) order “proportionate” remedial action, including damages? (iii) adopt interim measures to avoid risk of severe and irreparable harm, (iv) impose pecuniary sanctions (based on the company’s turnover), (v) impose other sanctions in order to produce a “effective, proportionate and dissuasive” package. (Arts 18(5) and 20).

Damages

Corporate damages possible via two routes:

(a) made by companies under Art 8.3(a) as part of a “neutralisation” strategy;

(b) (possibly) ordered by a supervisor under Art 18(5)(a) as part of a “remediation” strategy;

(c) awarded by a court under the free-standing liability provisions of Art 22 for breaches of Arts 7 and 8 (initiated by those who allege they have suffered harm).

Not clear how far MSS are to apply their own liability rules or are required to make modifications to them. For example, is liability under Art 22 required to be strict. (Express negligence defence set out only in relation to “indirect business partners”.)

Commission says Art 22 “will limit the risk of excessive litigation”. Incidence of litigation is likely to be dependent on whether group legal action is facilitated, whether third-party funding is available and whether the plaintiffs’ bar is well established – all matters outside Art 22.

TWO DIFFICULT ISSUES

(1) Responses by non-EU home states

Nestlé USA Inc v Doe 141 S.Ct. 1931 (2021) – US Supreme Court

Action by citizens of Ivory Coast under the Aliens Torts Statute against *US subsidiary* of Nestlé, alleging it aided and abetted child slavery in that country by purchasing (under an exclusive arrangement) cocoa from the farms where the abuses took place.

Supreme Court dismissed the claim, inter alia, on the grounds that the alleged wrongdoing took place outside the US and there was no evidence that the US sub instigated or approved the alleged wrongdoing. The purchasing decision not enough by itself to implicate the US subsidiary.

Suppose a US headquartered multinational and its EU sub, but otherwise the facts the same.

Sub might be liable for damages for wrongdoing occurring outside the EU where the sub's relationship with the wrongdoing was only contracting for supplies.

Would this incentivise the US courts or government to take a broader view of the ATS?

(2) Host state complicity

Kiobel v Royal Dutch Shell 133 S.Ct. 1659 (2013) (US Supreme Court)

Nevsun Resources Ltd v Araya 2020 SCC 5 (Supreme Court of Canada)

AAA v Unilever plc [2018] EWCA Civ 1532 (Court of Appeal of England and Wales)

How are the political dynamics to be handled by under Art. 8, by companies, supervisors and courts?

Potential to cut across alternative mechanisms for addressing human rights abuses

"the allegations here implicate a partnership (the Harkin-Engel Protocol and subsequent agreements) between the Department of Labor, petitioners [Nestlé], and the Government of Ivory Coast. Under that partnership, petitioners provide material resources and training to cocoa farmers in Ivory Coast—the same kinds of activity that respondents contend make petitioners liable for violations of international law. Companies or individuals may be less likely to engage in intergovernmental efforts if they fear those activities will subject them to private suits."