

European Union Justice Commissioner Commits to Regulation on Corporate Human Rights and Environmental Due Diligence

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Business and Human Rights

"Businesses that have better risk mitigation processes across their supply chains cause less harm to people... Good environmental, social, and governance practices pay off... We need to make sure that responsible business conduct and sustainable supply chains become the norm."

EU Commissioner for Justice, Didier Reynders, April 29, 2020

On April 29, 2020, in a [webinar](#) hosted by the European Parliament's Responsible Business Conduct Working Group, EU Commissioner for Justice Didier Reynders announced that the European Commission (the "Commission") will move swiftly to introduce regulation on mandatory human rights and environmental due diligence for companies, with its legislative proposal to the European Parliament and Council expected in the first quarter of next year.

In this alert, we provide an overview of the comments and commitments made by Commissioner Reynders against the backdrop of the recently published [Study on Due Diligence Requirements Through the Supply Chain](#) (the "Study"), which considered possible EU-wide regulatory interventions relating to human rights and environmental due diligence, and which provides the impetus for the Commissioner's announcement.

Consultations to inform the Commission's legislative proposal are expected to start in the coming weeks, so we also set out some initial factors that commercial organizations operating in the European Union may want to consider as they seek to engage with this policy process.

Background: the Study

Commissioner Reynders's presentation centered around the findings of the Study, which was published in late February and conducted by an expert panel that included representatives of the British Institute of International and Comparative Law, the London School of Economics and Political Science, and Civic Consulting, a public policy consultancy.

The Study involved: (i) a detailed examination of existing regulations and proposals for supply chain due diligence requirements, as well as market practices; (ii) the development of four general options for regulatory interventions at the EU level; and (iii) an assessment of the potential impact of these four options, based also on stakeholders' perceptions of the different regulatory interventions.

In high-level terms, the Study identified and evaluated the following four options:

- **Option 1—No EU level policy change:** This option would not involve any harmonized EU level regulatory intervention. The Study indicates that this option would be likely to result in a “patchwork” of due diligence expectations across the EU, as there are pending proposals or campaigns for mandatory human rights and environmental due diligence laws in 13 European countries, of which 11 are EU Member States.
- **Option 2—New EU level guidance:** This option would involve the creation of EU level, non-legally binding guidance on undertaking supply chain due diligence.
- **Option 3—New regulation requiring due diligence reporting:** This option would involve the introduction of new EU legislation to require in-scope entities to report on the steps they have taken to identify, address, prevent, and mitigate any adverse human rights and environmental impacts in their own operations, or those of third party businesses with which they have relationships. The regulation would differ from existing reporting legislation, including the EU Non-Financial Reporting Directive (Directive 2014/95/EU), as it would expressly focus on risks to people and planet, rather than on investment risks for shareholders.
- **Option 4—New regulation requiring mandatory due diligence as a legal duty of care:** This option would involve the introduction of a new EU regulation to require in-scope entities to carry out due diligence to identify, prevent, mitigate and account for actual or potential human rights and environmental impacts in their own operations and supply or value chains, as a legal duty or standard of care.

The Commission's Response to the Study

The Responsible Business Conduct Working Group—an informal cross-party group of Members of the European Parliament—was initially set to discuss the Study with Commissioner Reynders in early March, but the exchange was postponed and moved online due to the coronavirus pandemic. The Commissioner framed his discussion against the backdrop of the current public health emergency and the need to encourage sustainable supply chains as the economy rebuilds.

In the webinar, Commissioner Reynders noted that voluntary action to address corporate human rights violations, as well as climate and environmental harms, had not brought about sufficient change. In that regard, he noted the Study's finding that only one in three businesses in the EU currently are undertaking comprehensive human rights and environmental due diligence. In reaction to these and other findings of the Study, Commissioner Reynders

emphasized the need for new regulation with the intention to introduce a “mandatory mechanism”.

The Commissioner highlighted business respondents’ preference for mandatory due diligence regulation (“Option 4”) in the Study, and also referenced a similar [call](#) for regulatory action by the Investor Alliance for Human Rights, a group of 105 investors representing US\$5 trillion in assets under management.

He also emphasized the potential advantages of a harmonized, EU-wide due diligence regulation. For instance, approximately two-thirds of all businesses surveyed as part of the Study agreed that an EU level regulation could benefit business by creating legal certainty, including by avoiding a proliferation of overlapping or competing national standards. Similarly, almost 72 per cent of all business respondents agreed that EU-wide regulation may level the playing field for commercial operators in the EU and beyond.

Commissioner Reynders indicated that the Commission is currently preparing a public consultation on sustainable corporate governance and due diligence which will inform the Commission’s legislative proposal.

Current Uncertainties as to Scope of a Mandatory Due Diligence Regulation

When the Commission’s public consultation opens, it will provide a significant opportunity for commercial organizations and other stakeholders to engage with the legislative process, and to shape its eventual outcome. The Commissioner noted that the exact design of a mandatory due diligence mechanism will be proposed only after these consultations, and that he expects many ideas to reach him through the consultation process.

There are several key scoping issues that are likely to be central to the consultation on the proposed due diligence regulation, some of which were considered in the Study in relation to potential “sub-options” of option 4. We summarize the key issues below.

To whom would any regulation apply?

The Study noted that any new regulation could be limited to particular sectors or be cross-sectoral in application. It also could impose more stringent obligations on larger firms than are imposed on small and medium-sized enterprises (“SMEs”). With respect to this issue, Commissioner Reynders expressed a strong preference for cross-sectoral regulation. However, he acknowledged the specific position of SMEs, and noted that special accommodations for SMEs would likely have to be included as part of any regulation.

What would a due diligence obligation require?

Any legally-binding due diligence requirements would likely build on existing international standards and best practices, such as those set out in the UN Guiding Principles on Business and Human Rights (“UNGPs”), and include the following four elements: (1) identifying and assessing actual and potential impacts that a company may cause or contribute to through its own activities, or which may be directly linked to its operations, products or services by its business relationships; (2) acting upon the findings of the assessment, and integrating those findings into decision-making; (3) tracking the effectiveness of any actions taken by the company; and (4) communicating how impacts are addressed, including through reporting.

With regard to the breadth of any potential due diligence obligations, the Study noted that the UNGPs refer to a company’s “value chain”—i.e., the entire life cycle of a product or service—rather than the “supply chain”. Stakeholders consulted for the Study were therefore asked questions about both upstream supply chains and downstream value chains, but the Study found that current business practice generally focuses due diligence efforts on upstream supply chains only. This is likely to be a central issue in the forthcoming consultation.

How would due diligence obligations be enforced?

In his presentation, Commissioner Reynders observed that “a regulation without sanctions is not a regulation”. The Study suggested that enforcement mechanisms could range from judicial remedies to administrative actions, such as the appointment of monitors or the withdrawal of operating licenses. The institutional structure of any EU-wide due diligence regime will also have to be carefully considered, and Commissioner Reynders made reference to a possible combination of civil and criminal sanctions, with supervisory authorities at the Member State level that would be integrated through an EU network to ensure consistency in enforcement practices. For commercial organizations subject to any regulation, the details of these institutional structures are likely to determine the coherence, effectiveness, and burdensomeness of their new due diligence obligations.

What support might be provided to businesses, if any?

Balanced against the perceived benefits of a mandatory due diligence obligation, the Study recognized that any mandatory due diligence requirement would entail substantial costs for businesses and Member State governments. In particular, if a cross-sectoral regulation were to be adopted, the Study estimates that the annual additional compliance cost for EU companies may amount to EUR 33 billion—with SMEs bearing the majority of that additional burden (approximately EUR 32.5 billion). Each Member State also would be required to develop and implement structures and processes to monitor compliance, and pursue enforcement actions in appropriate cases—although the estimated cost to governments would depend on the nature of the enforcement mechanism that is adopted.

Commissioner Reynders noted that companies will need to be “protected” during any legislative change, particularly in the wake of the coronavirus pandemic.

Stakeholder Engagement To Date

Numerous stakeholders, representing a variety of interests, have been engaged with policy discussions regarding value chain due diligence obligations, particularly since the Study’s publication:

- **European Parliament (the “Parliament”):** For many years, Members of the European Parliament (“MEPs”) have been advocating for mandatory due diligence obligations in the supply chain. The May 2018 [Report on Sustainable Finance](#), which provided a mandate for the Study, was supported by a substantial majority of MEPs, and called on the Commission to provide a legislative proposal for an overarching, proportionate, and mandatory due diligence framework. Specifically, it advocated for any regulatory framework to be based on the [Guidelines on Responsible Business Conduct for Institutional Investors](#), which were published by the Organization for Economic Cooperation and Development (“OECD”) in 2017, and the French Corporate Duty of Vigilance Law, which requires certain entities to identify and prevent human rights and

environmental risks that could arise as a consequence of their business activities. In his remarks on the Study, Commissioner Reynders referenced these standards, as well as the OECD's [Due Diligence Guidance for Responsible Business Conduct](#), which was published in May 2018, as important benchmarks for the EU's regulatory approach. Just last month, in a [resolution](#) on action to combat the coronavirus pandemic, the Parliament said that it is "convinced that corporate human rights and environmental due diligence are necessary conditions in order to prevent and mitigate future crises and ensure sustainable value chains". Additionally, Bernd Lange, chair of the Parliament's influential International Trade Committee, published a [position paper](#) on April 29 calling for a "binding supply chain law".

- **Member States:** The shape of any final EU regulation on corporate due diligence will be a function of the preferred approach among a majority of Member States. The exact policy preferences among the 27 countries are likely to crystallize over this year, as the consultations progress. Finland has already signaled its support for this legislative initiative during its 2019 Council Presidency, and Germany also now appears to be positively disposed towards the introduction of an EU-wide regulation. In the webinar with Commissioner Reynders, a representative of the German Ministry for Labor and Social Affairs stressed that "there should be a mandatory legally binding EU due diligence standard—a standard with adequate capacity to enforce". Commissioner Reynders welcomed these statements and mentioned that the Commission and the German Government could actively collaborate on this agenda once Germany takes over the Council Presidency in July. This may signal a significant combination of political capital in Brussels, further increasing the likelihood that this legislative initiative will gain momentum.
- **Business:** The view of businesses will be a crucial factor for the Commission to consider in the forthcoming consultations, and is likely to inform many of the policy choices ahead. As mentioned above, a large investor group has already voiced support for binding legislation, and some trade associations have issued similar statements ([for example, the Association of Chocolate, Biscuits and Confectionary of Europe](#)). We expect that differing views will emerge regarding the scope and mechanics of any new regulation as the consultations progress.
- **Civil Society:** A broad range of civil society organizations—including anti-deforestation activists, labor organizations, and children's rights groups—are honing in on the Commission's corporate due diligence agenda as a means to achieve their ends. The European Coalition for Corporate Justice has already published a legal briefing paper that sets out suggested model provisions for EU legislation, and we expect that civil society organizations are likely to increase their lobbying efforts in this field, and participate actively in the Commission's consultations.

Related EU Developments

Commissioner Reynders' announcement took place against the backdrop of a wider set of important and related developments relating to the so-called "European Green Deal", the European Commission's roadmap to make the EU's economy more sustainable, with net zero greenhouse gas emissions by 2050.

The Commission has generally [noted](#) that sustainability should be further embedded into the corporate governance framework. To that end, the Commission has started [consultations](#) on a new sustainable finance strategy, building on the Commission's 2018 [Action Plan](#). The renewed strategy is to "provide a roadmap with new actions to increase private investment in sustainable projects and activities to support the different actions set out in the European Green Deal and to manage and integrate climate environmental risks into our financial system." The consultation contains questions regarding sustainable corporate governance and due diligence.

In addition, on a sector-specific level, three European Union supervisory authorities for financial services (the European Banking Authority, the European Insurance and Occupational Pensions Authority, and the European Securities and Markets Authority) last month issued a [consultation paper](#) seeking input on proposed environmental, social and governance disclosure standards for financial market participants, advisers, and products. These draft Regulatory Technical Standards regarding the content, methodologies, and presentation of sustainability-related disclosures in the financial services sector are being developed under EU Regulation [2019/2088](#).

We will be closely tracking the developments described in this alert on behalf of our clients, and any questions relating to these issues should be directed to the following members of our business and human rights practice:

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