

FEBRUARY 2021

SUSTAINABLE CORPORATE GOVERNANCE CONSULTATION RESPONSE

The DIHR welcomes the introduction of the Sustainable Corporate Governance Initiative (the **Initiative**) by the European Commission and are pleased to provide this response to the Consultation on the Sustainable Corporate Governance Initiative (the **Consultation**).

The Initiative is accompanied by strong messages from other organs of the EU on the importance of introducing a mandatory human rights and environmental due diligence measure at the EU level: the European Parliament has of its own initiative prepared a draft proposal on mandatory human rights due diligence and on 1 December 2020 Conclusions from the European Council were approved calling on the Commission to bring forward a proposal for an EU legal framework on sustainable corporate governance, including cross-sector corporate due diligence obligations along global supply chains in 2021.

The DIHR response draws from the expertise of the Human Rights and Business Department, which has worked for 20 years with companies, states and civil society to build a global environment in which negative impacts on human rights by business activities are minimised, including through implementation of the UN Guiding Principles on Business and Human Rights.

THE SMART MIX AND THE NEED FOR MANDATORY MEASURES

- **Voluntary measures are insufficient to ensure corporate respect for human rights as envisaged by the UNGPs**
- **The EU should introduce mandatory measures as part of the smart mix**

Under the [UN Guiding Principles on Business and Human Rights \(UNGPs\)](#), all businesses have a responsibility to respect internationally-recognised human rights, regardless of their size, sector, ownership or country of operation. This responsibility

applies independently of whether governments in companies' home or host states fulfil their own duties enshrined under international human rights law to protect human rights against business-related abuses.¹

The UNGPs call for all businesses to undertake due diligence to operationalize their corporate responsibility to respect human rights, as well as for states to adopt legislative and other regulatory measures 'to prevent, investigate, punish and redress' business-related human rights abuses. In order to

¹ UNGPs, GP 18.

facilitate respect for human rights by business and the discharge of state obligations, the UNGPs advocate that a “smart mix” of voluntary and mandatory measures be adopted.

It is becoming increasingly apparent that voluntary measures are insufficient to realise the objective of ensuring corporate respect for human rights set out in the UNGPs. Recent studies have revealed shortcomings in the implementation of the UNGPs by business.² This includes a [2020 snapshot report](#) prepared by the DIHR using the Corporate Human Rights Benchmark core indicators methodology (**DIHR Snapshot**) which shows that 20 of the biggest Danish companies are currently not demonstrating full alignment with the responsibility to respect human rights, as defined by the UNGPs.

Mandatory human rights due diligence is an essential component of a smart mix of measures required to ensure that corporations meet their responsibility to respect human rights as outlined in international standards. A [number of states](#) including France, Switzerland and Germany have enacted or have taken steps to enact legislation requiring that companies

² A 2019 report from the Alliance for Corporate Transparency analysed the reporting practices of 1000 companies under the Non-Financial Reporting Directive found that only 22.2% of companies disclosed information on their human rights due diligence

undertake due diligence not only with respect to human rights impacts, but also environmental, climate change and social and governance impacts.

The 2030 Agenda for Sustainable Development and its 17 Sustainable Development Goals (**SDGs**) build on and reflect major multilateral agreements and frameworks, including on human rights. [Analysis by the DIHR](#) shows that over 90% of the goals, targets and indicators implicitly or explicitly reference international labour and human rights norms. It is therefore critical that human rights be central to any initiative aimed at realising the SDGs. The 2030 Agenda clearly calls on business to contribute to the realisation of the SDGs while insisting on the importance of responsible business conduct and respect for human rights by business. The process of human rights due diligence set out in the UNGPs provides a roadmap for business engagement with the SDGs by ensuring that business related human rights impacts are identified and addressed and that effective remedy is available in the event that harms occur.

The introduction of such a due diligence obligation at the EU level is supported by

processes despite 82.8% reporting a human rights policy. Further, only 25.5% of companies disclose specific human rights risks facing them despite 56.6% acknowledging those risks. Only 14.6% report on actual impacts and only 3.6% explain the outcomes of the management of those risks.

findings from a recent study commissioned by DG JUST³ on due diligence requirements to identify, prevent, mitigate and account for abuses of human rights, including the rights of the child and fundamental freedoms, serious bodily injury or health risks, environmental damage, including with respect to climate (the **DG JUST Study**). The study assessed various regulatory options and found that the introduction of a mandatory due diligence measure would generate the most significant positive human rights, environmental and social impacts when supported by appropriate monitoring and enforcement mechanisms.⁴ The DG JUST Study found that: voluntary initiatives, even when backed by transparency do not sufficiently incentivise good practice; there exists wide stakeholder support, including from frontrunner businesses, for mandatory EU due diligence; and that 70% of businesses responding to the survey conducted for the study agreed that EU regulation might provide benefits for business, including legal certainty, level playing field and protection in case of

litigation. A cross-sectoral regulatory measure, at EU level, was preferred to sector specific frameworks.

Recent studies have also revealed shortcomings in the implementation of the UNGPs by business, including the [DIHR Snapshot](#) referred to above, as well as a number of other studies including the [Corporate Human Rights Benchmark](#), [Alliance for Corporate Transparency](#) as well as studies commissioned by the [German](#) and [Dutch](#) governments, the [Danish Institute for Human Rights](#), and [Trinity College Dublin](#), which showed a low uptake of human rights due diligence processes by companies when done on a voluntary basis.

The DG JUST Study also outlined some significant findings on market practice among EU businesses. A survey of business and other stakeholders found that “human rights due diligence” was the most commonly used term by businesses to describe their due diligence practices.⁵ Interviews with business

³ BIICL et al, [Study on due diligence requirements through the supply chain](#), European Commission (January 2020)

⁴ BIICL et al, [Study on due diligence requirements through the supply chain](#), European Commission (January 2020), p23.

⁵ According to the study, “The terminology selected by most business respondents (32.43%) and general respondents (54.10%) is “human rights due diligence”. This is followed by a mix of other phrases (18.92% business, 36.61% general) related to supply chain due

diligence, supplier codes of conduct or ethical sourcing. In the business survey, the third most selected phrase was “sustainability due diligence”, but only selected by a few (14.19%), and followed closely by “social, environmental and human rights due diligence” (13.51%). In the general survey, “social, environmental and human rights due diligence” was the third most-selected options, by 35.52%, before “sustainability due diligence”, selected by 30.05%” BIICL et al, [Study on due diligence requirements through the supply chain](#), European Commission (January 2020) at p59.

respondents surveyed “suggested that any regulatory mechanism should build upon the influence and strength of the due diligence concept of the UNGPs. Several references were made to the uptake which the UNGPs have had, also in terms of due diligence expectations contained in the OECD Guidelines for Multinational Enterprises (**OECD Guidelines**), and other mechanisms. The OECD Guidelines were frequently mentioned as an example of how the UNGPs concept of due diligence can be expanded and applied to other areas of responsible business conduct such as impacts on the environment and climate change.”⁶

Consistent with these findings, it is important that any due diligence measure introduced as part of the Sustainable Corporate Governance initiative be mandatory and be based on the concept of human rights due diligence outlined in the UNGPs, the OECD Guidelines for Multinational Enterprises and the OECD Due Diligence Guidance for Responsible Business Conduct.

The Consultation raises a number of complex issues with respect to the design of a future legal framework. We make a number of specific comments on some select aspects of the Consultation in the following sections.

NEED FOR MANDATORY HUMAN RIGHTS DUE DILIGENCE

- **The EU should introduce a mandatory human rights due diligence measure requiring companies to identify, address and remediate human rights impacts**
- **A mandatory measure should build on the UNGPs and other authoritative international frameworks**

An EU level framework for mandatory due diligence should be developed to identify, address and remediate adverse human rights and environmental impacts. The due diligence process should be a continuous process to identify risks and adverse impacts on human rights, health and safety and environment and prevent, mitigate and account for such risks and impacts in their operations and through their value chain. This approach should build on relevant international standards on business and human rights and responsible business conduct, such as the UNGPs, OECD Guidelines and OECD Due Diligence Guidance for Responsible Business Conduct (**OECD Due Diligence Guidance**). Such an approach would reinforce and [support the commitments made by 15 EU member states](#) to human rights due diligence contained in their national action plans on business and human rights.

⁶ BIICL et al, [Study on due diligence requirements through the supply chain](#), European Commission (January 2020) p59.

A well designed, EU legal framework which includes a mandatory human rights and environmental due diligence obligation on companies would be an important step towards ensuring that companies operating in the EU or providing goods and services to the EU single market are aware of their adverse human rights, social and environmental impacts and risks related to human rights violations other social issues and the environment and that they are in a better position to mitigate those risks and impacts, and remediate where necessary. It is clear from the results of the DG JUST Study and other studies referenced above that voluntary measures alone are insufficient to adequately regulate the human rights and environmental impacts of businesses.

The UNGPs call for a smart mix of measures to regulate business impacts on human rights, which includes both voluntary and mandatory measures at the national and international level. At present, the mandatory component of the smart mix is under-developed. An EU level measure which imposes mandatory requirement on companies to undertake due diligence would be a significant contribution to the smart mix of measures.

In recognition of the important role of the private sector in the realisation of the 2030 Agenda for Sustainable Development, such an initiative would contribute to sustainable development, including in non-EU countries.

One of the most important contributions

businesses can make towards the SDGs is to undertake human rights and environmental due diligence. A horizontal, cross-sectoral measure applicable to all companies would also have the benefit of facilitating a level playing field and signaling to non-EU businesses the standard of conduct expected of businesses operating in, headquartered in, and/ or supplying to the EU. An EU level measure would increase legal certainty for companies who are currently operating in a fragmented regulatory landscape. A measure which includes an effective sanctions and remedy mechanism would also provide a valuable avenue for redress to those who have suffered harm as a result of corporate human rights abuses or environmental degradation, a significant challenge under the present legal landscape and would serve as a means to implement the recommendations from the [UN OHCHR Accountability and Remedy Project: Improving accountability and access to remedy in cases of business involvement in human rights abuses](#).

DEFINING DUE DILIGENCE

- **Any definition of the due diligence duty should align with the UNGPs and other internationally recognised standards**

The definition of “due diligence duty” in the Consultation is stated to refer to a legal requirement on companies to “establish and

implement adequate processes with a view to prevent, mitigate and account for human rights, health and environmental impacts". The DIHR is of the view that the definition should more closely align with the UNGPs, OECD MNE Guidelines and OECD Due Diligence Guidance and require companies to: identify and assess actual and potential adverse impacts; cease, prevent and mitigate adverse impacts; track implementation and results; communicate how impacts are addressed; and provide for or cooperate in remediation.

In particular, an obligation to provide for or cooperate in remediation is missing from the definition proposed by the consultation. Access to effective remedy is a critical part of accountability and realisation of the human rights of rightsholders impacted by the acts of a company. The role of the company in facilitating access to remedy should be recognised in the defined due diligence duty.

Further, the definition of "supply chain" is stated to be "understood within the broad definition of a company's 'business relationships' and includes subsidiaries as well as suppliers and subcontractors". The inclusion of subsidiaries within the definition of supply chain does not accord with a common understanding of the term has the potential to create ambiguities – although a

subsidiary may be in a supplier relationship with a parent company, this is not always the case. The DIHR is of the view that subsidiaries should be treated separately in the definition of due diligence rather than included in the definition of "supply chain". Consistent with the approach in the UNGPs, companies should be required to avoid causing or contributing to adverse human rights impacts through their own activities and seek to prevent or mitigate adverse human rights impacts that are directly linked to their operations, products or services through their business relationships, regardless of whether the company has contributed to such an impact. This should require a company to undertake due diligence in the company's own operations, including its subsidiaries and related entities and in the company's whole value chain, acknowledging that for some businesses the risk of the most severe impacts may be upstream rather than downstream in the value chain.

The Consultation states that the definition implies "that the extent of implementing actions should depend on the risks of adverse impacts the company is possibly causing, contributing to or should foresee". Consistent with the approach in the UNGPs, severity of the impact should be the main parameter on which companies should prioritise action in relation to human rights and environmental risks alongside the specific circumstances of the company, particularly their sector of

activity, the size and complexity of the value chain, and the size of the undertaking. While a requirement that implementing actions that have regard to impacts that are foreseeable would in some cases capture impacts to which a company is directly linked, the concepts are not synonymous. To align with the UNGPs, companies should be required to undertake due diligence which assesses impacts to which a company is directly linked. This means that the due diligence duty is likely to be broader in scope than the scope of any civil liability for harms caused or contributed to by the company through the application of ordinary tort principles. This is consistent with the approach taken in the UNGPs, which maintain that the responsibility of business enterprises to respect human rights is distinct from issues of legal liability and enforcement.

SCOPE OF DUE DILIGENCE

- **Any due diligence obligation should be horizontal and cross-sectoral, applying to all companies providing goods or services to the EU single market**
- **The due diligence obligation should cover all internationally recognised human rights and align with the UNGPs**

The Consultation questionnaire presented a number of alternative models for the design of a due diligence measure. However, when asked to select a preferred model, the DIHR selected “none of the above” because of

concerns that each of the models proposed could lead to a checkbox compliance approach. Any due diligence requirement must be designed with a view to achieving the ultimate objective of ensuring respect for human rights by business and conform to the requirements in existing frameworks including the UNGPs, the OECD Guidelines for Multinational Enterprises and the OECD Due Diligence Guidance.

Aligned with those frameworks, the following minimum requirements should be featured as part of any proposed mandatory due diligence duty:

- Businesses should, at a minimum, respect the human rights expressed in the International Bill of Human Rights, incl. the Universal Declaration on Human Rights, the core UN human rights conventions, and the ILO core labour standards which relate to forced labour, child labour, freedom of association and collective bargaining, and discrimination.⁷ Businesses should be expected to adhere to additional human rights standards relevant in their circumstances.
- The due diligence obligation should therefore include all internationally recognised human rights (including civil and political rights, fundamental labour

⁷ UNGPs, GP 18.

rights and human rights at work connected to occupational health and safety, decent wages and working hours; economic social and cultural rights as well as rights of specific groups, such as women and girls, indigenous peoples, people with disabilities etc); environment and climate change impacts;

- Any due diligence duty should be horizontal, cross-sectoral and cross-thematic, consistent with the approach in the UNGPs, pursuant to which all companies, regardless of size or sector have a responsibility to respect human rights. An approach which applies only to particular sectors or issues is limiting, adding an additional administrative burden, particularly for businesses which operate across sectors which may have an adverse effect on meaningful engagement with the due diligence obligation. Such an approach also contributes to the risk of fragmentation;
- A broad due diligence obligation could be accompanied by thematic or sector specific guidance which clarify the obligations of companies operating in specific sectors. A similar approach has been taken by the OECD in preparing due diligence guidance for high-risk sectors or issues including extractives, apparel, agriculture, finance, sourcing of minerals

from conflict-affected and high-risk areas and child labour which supplement and clarify the overarching responsibilities set out in the OECD Guidelines for Multinational Enterprises;

- Consistent with the approach set out in the UNGPs, the due diligence obligation should apply to all companies providing goods or services to the EU single market or otherwise being taken to be doing business within the EU;
- Human rights and a safe, clean, healthy and sustainable environment are interdependent, as highlighted in the [UN Framework Principles on Human Rights and the Environment](#), as well as by various UN Human Rights treaty bodies and regional courts. Environmental harms such as air and water pollution, climate change, loss of biodiversity and deforestation are recognised as impacting on the enjoyment of human rights and should be included in the due diligence obligation;
- Risks to rights-holders should be central to all due diligence processes, whether in respect of human rights harms or environmental harms; and
- Any due diligence measure should be accompanied by an appropriate enforcement mechanism which includes oversight and monitoring by an

adequately resourced supervisory body with powers of investigation and enforcement supported by a civil liability mechanism.

SMALL AND MEDIUM SIZED ENTERPRISES

- **SMEs should be covered by any proposed measure, but with additional support in the form of guidance, toolboxes or helpdesks**
- **A “phase in” approach could be adopted which allows an additional lead time for SMEs to comply with a due diligence requirement**

Consistent with the approach in the UNGPs, pursuant to which all companies, regardless of size or sector have a responsibility to respect human rights, any due diligence duty should apply to all companies.

According to the ILO, micro, small and medium sized enterprises (**MSMEs**) – a large portion of which are informal enterprises – represent [about 70% of total employment worldwide](#) and even more in low and middle-income countries. SMEs can have a severe impact on the enjoyment of human rights. Depending on the nature of the business, SMEs may not have the same human rights impacts as larger companies, however they may still negatively impact on human rights of

workers in the shape of low pay, poor working conditions, a lack of social security and disproportional adverse effects on women. It is therefore important that they be included within the scope of any proposed measure.

Capturing SMEs in the regulation would not impose an undue burden. The DG JUST study found that the costs of carrying out mandatory supply chain due diligence appears to be relatively low compared to the company’s revenue. The additional recurrent company-level costs, as percentages of companies’ revenues, amount to less than 0.08% for SMEs.⁸ Requiring SMEs submitted to comply with the due diligence obligation could help them to live up to standards that will be expected by large business with which they have business relationship.

The UNGPs make it clear that the responsibility to respect human rights is shared by all businesses, regardless of size or sector. The means through which a business enterprise meets its responsibility to respect human rights will however be proportionate to its size and nature of its operations. A measure should build on and reinforce such an approach. A “phase in” approach could be considered which allows an additional lead time for SMEs to comply with a due diligence requirement which could include lighter requirements in the first phase, as well as

⁸ DG JUST Study Table 8.33 p427-428

support in the form of capacity building, guidance and toolboxes or helpdesks.

NEXUS TO THE EU

- **A proposed due diligence measure should cover all businesses supplying goods or services to the single market**

The UNGPs, which were endorsed unanimously by the United Nations Human Rights Council, are applicable to all companies, regardless of geography. Accordingly, companies both within and outside the EU already have a responsibility to respect human rights, in some cases supported by other initiatives such as through National Action Plans on Business and Human Rights. The obligation to undertake due diligence should apply to third country companies in respect of business done in whole or in part in the EU including through the provision of goods and services to the single market. An example can be found in respect of the EU Timber Regulation which creates jurisdictional nexus by virtue of ‘placing on the market’ meaning the supply by any means, irrespective of the selling technique used, of timber or timber products for the first time on the internal market for distribution or use in the course of a commercial activity, whether in return for payment or free of charge.

Finally, post implementation of mandatory human rights and environmental due diligence in the EU, it might be relevant to draw inspiration from the International Platform on Sustainable Finance, that provides an international platform to promote EU’s sustainable finance efforts including the Taxonomy. A similar platform could be an option to support international uptake and harmonisation around mandating corporate due diligence on human rights and the environment.

ENFORCEMENT

- **Compliance with any mandatory due diligence obligation should be monitored by an adequately resourced supervisory body with powers of investigation and enforcement**
- **Any proposed measure should include scope for civil liability**

As the DG JUST Study and other studies referenced above have shown, voluntary measures are insufficient. In order for a mandatory due diligence measure to be effective it must be accompanied by enforcement mechanisms. This should take the form of regulatory oversight by national competent authorities who are empowered and adequately resourced to respond to complaints, and direct mechanisms for stakeholders to seek remedy for adverse impacts including judicial enforcement with liability and compensation for harms caused by a failure to undertake due diligence.

Access to remedy for affected rightsholders remains a significant challenge. While litigation should be a mechanism of last resort, providing a pathway to civil liability through judicial mechanisms is a critical component to the discharge of this obligation,⁹ adding force to other softer mechanisms which may be used to encourage companies to engage in meaningful due diligence.

The potential for businesses to be legally liable for human rights or environmental harms through civil claims is not new. Developing jurisprudence in the UK, Canada, US and various European jurisdictions creates a tangible legal risk that a company may be liable for harms caused by a failure to undertake adequate due diligence, or prevent a human rights harm.¹⁰ As well as providing a much-needed avenue to remedy for affected rightsholders, setting clear parameters in a mandatory HRDD measures for when a company may be liable for harms caused by a failure to conduct due diligence could provide welcome clarification for businesses currently at risk of liability exposure. While some

jurisdictions, primarily those which are founded on UK common law, have developed a body of case law which allows for the possibility of civil liability for business related human rights harms, this is not the case across all EU jurisdictions, nor farther afield.

A mandatory human rights due diligence measure which clarifies avenues to civil liability can further facilitate a level playing field by creating a set of common conditions for liability to attach. It would also serve as means to implement the recommendations of the [UN OHCHR Accountability and Remedy Project: Improving accountability and access to remedy in cases of business involvement in human rights abuses](#).

Under the UNGPs, the responsibility of business enterprises to respect human rights is distinct from issues of legal liability and enforcement. Accordingly, the scope of potential liability for harm may not necessarily be coextensive with the scope of the due diligence obligation. Where a due diligence obligation is cast in broad terms aligning with the terms of the UNGPs, covering all companies, sectors and penetrating the

⁹ UNGPs, GP26

¹⁰ *Chandler v Cape Plc* [2012] EWCA Civ 525, *Vedanta Resources PLC and another (Appellants) v Lungowe and others (Respondents)* [2019] UKSC 20; *Okpabi & Ors v Royal Dutch Shell Plc & Anor* [2018] EWCA Civ 191 (under appeal); *Araya v. Nevsun Resources Ltd.* 2017 BCCA 401; *Akpan v Royal Dutch*

Shell PLC Arrondissementsrechtbank Den Haag, 30 January 2013 Case No C/09/337050/HA ZA 09-1580 (under appeal); *Choc v Hudbay Minerals Inc* [2013] ONSC 1414; *Garcia v Tahoe Resources* (2017 BCCA 39); *Jabir v KiK Textilien und Non-Food GmbH* 7 O 95/15.

entirety of the value chain, there is the potential for the due diligence obligation to be far more extensive than the scope of the liability mechanism.

According to the UNGPs, in practical terms, “conducting appropriate human rights due diligence should help business enterprises address the risk of legal claims against them”. Although the process of due diligence can be a means of mitigating legal risk, conducting human rights due diligence should not be an automatic defence to liability. As the UNGPs note, “business enterprises conducting such due diligence should not assume that, by itself, this will automatically and fully absolve them from liability for causing or contributing to human rights abuses.”¹¹ It is critical that any mandatory measure encourage meaningful engagement with the process of due diligence in order to mitigate risk of involvement in adverse human rights impacts and thereby legal risk.

Where due diligence operates as a defence, a company would avoid liability if it is able to demonstrate that it has undertaken the due diligence required in the circumstances. Due diligence should not be an automatic defence, rather the adequacy, the appropriateness of the due diligence conducted by companies should be considered. Regimes which have incorporated a form of due diligence defence such as the UK Bribery Act have included such

a reasonableness requirement. Other considerations, such as the kind of harm and the company’s involvement, the availability of other avenues to remedy and overarching policy objectives of the regulation are also relevant.

The availability of a due diligence defence could provide a powerful incentive for companies to implement due diligence measures and have a positive preventative effect. However, the standard by which such diligence efforts are assessed must be meaningful engagement and a genuine attempt to identify, mitigate, and address human rights risks in the spirit of the UNGPs, rather than a superficial box-ticking exercise. However, judicial remedy alone is not sufficient. Compliance with any mandatory due diligence obligation should be monitored by an adequately resourced supervisory body with powers of investigation and enforcement.

Claimants seeking accountability and remedy in the form of a claim described in the question face a range of procedural and substantive hurdles. These range from: challenges evidencing a claim, including limited mechanisms for prospective claimants to seek disclosure from a potential defendant in order to properly evidence their claim and gathering evidence in third countries; jurisdictional challenges which require prospective claimants to establish a sufficient nexus to an

¹¹ UNGPs, commentary to GP17.

EU jurisdiction in order to have access to a court; conflict of laws challenges including the application of restrictive *forum non conveniens* rules and rules determining the applicable law; challenges concerning the limitation of actions where a claim could potentially be live in a European court but the law of the third country prescribes a restrictive limitation period;¹² costs challenges which result in a claimant being effectively barred from bringing a claim due to the prohibitive expense of litigation and “loser pays” costs rules; and challenges concerning the availability of class action claims.

These challenges could be addressed by:

- Clarifying and expanding the basis for establishing jurisdiction of an EU court and the application of a less restrictive *forum non conveniens* rule of the kind used in Australia which provides that a claim should be heard unless the jurisdiction is a “clearly inappropriate forum”: see *Voth v Manildra Four Mills*.
- Implementing a mechanism for pre-action disclosure which allows claimants to access documents and information required in order to bring a claim.

- Establishing mechanisms by which claimants can overcome costs challenges, including allowing firms to take on claims on a contingency basis and potentially providing costs support for public interest claimants.
- Implementation of an EU wide class action regime with an opt out mechanism which would facilitate collective redress for business and human rights claims.

STAKEHOLDER CONSULTATION

- **A due diligence process should include meaningful stakeholder consultation which aims to address the power imbalances between the company and affected stakeholders**
- **In order to facilitate effective consultation, companies should be transparent**

Meaningful stakeholder consultation is a critical component of human rights due diligence as set out in the UNGPs. Stakeholder engagement enables businesses to understand perspectives of those who may be affected by their decisions and operations and is essential if a company is to adequately identify and address its human rights impacts

¹² For example, *Jabir v KiK Textilien und Non-Food GmbH* 7 O 95/15

with a focus on risks to rightsholders, rather than risks to the company.

Effective identification of and engagement with rightsholders better prepares businesses to avoid conflicts with workers, local communities and other groups, and provide effective remedy for harms, when required. Businesses should embed stakeholder consultation across all levels of the business and use different modes of engagement to help prevent harm, mitigate risks of negative impacts on those people, communities and the environment, and devise adequate systems for compensating for loss or damage.

Existing stakeholder engagement practices, such as those related to materiality assessments, might not be fully aligned with the stakeholder consultation requirement of the UNGPs. A measure should make explicit that stakeholder engagement should not just be about identifying stakeholder interests, but also about identifying potential and actual human rights risks and developing relevant mitigating actions.

In order to facilitate effective consultation, companies should be prepared to be forthcoming and disclose relevant information to potentially affected stakeholders. This should include its plans, details on how it is managing potential and actual negative

impacts and reporting on the outcomes of its efforts.

All mechanisms for stakeholder engagement must seek to address the power imbalance between the company and the affected persons or groups. Engagement processes should aim to understand how existing vulnerabilities may create disproportionate impacts for certain groups including indigenous peoples and communities, forest communities, coastal communities, migrant workers and women. Special attention should also be paid to implementing a gender-based approach when appropriate.

Where indigenous peoples and communities may be affected, businesses must be required to adhere to international standards on principles of free, prior and informed consent (**FPIC**). Consultations should be undertaken in good faith in accordance with appropriate procedures, in particular, through indigenous peoples' representative institutions. Indigenous peoples should be free to participate at all levels of decision making and FPIC should be obtained before adopting any measures which may affect them.

All persons or groups that are, or could potentially be, directly or indirectly affected by the business' project or operations should be represented. This includes a range of

persons and other actors who are credible proxies, such as: workers; trade unions; NGOs; community members; indigenous peoples and communities; forest communities; human rights, land and environmental defenders; women and women's organizations; community leaders; faith-based organizations; and local authorities.

Relevant experts on human rights, environment, climate or other subject matter areas should form part of the stakeholder engagement process.

DIRECTORS DUTIES AND CORPORATE GOVERNANCE

- **A directors duty alone is insufficient – any legal framework operationalising the Initiative must include a mandatory due diligence obligation**

A directors duty to have regard to the interests of a broad range of stakeholders would be welcomed. However, a directors duty alone is insufficient to ensure that a company identifies and addresses its human rights impacts, and facilitates access to effective remedy to rightsholders who are impacted by the activities of a company. A mandatory due diligence obligation on the company to identify and address human rights and environmental impacts with a focus on rightsholders is required which complements and aligns with any proposed obligation on directors.

Businesses can have a significant impact on the interests of a broader range of stakeholders beyond those with a financial interest in the financial performance of a company, such as shareholders. Such stakeholders include workers and worker organisations, customers, suppliers, and local communities impacted by business activities, such as indigenous peoples. The responsibility of business to a broader set of stakeholders is gaining acceptance amongst the business community, including by the [US Business Roundtable](#) which released a statement in 2019 signed by 181 CEOs seeking to redefine the purpose of a corporation to align with a stakeholder model.

Companies and their directors should have due regard for stakeholder interests', including on issues such as human rights violations, environmental pollution and climate change. Businesses can have a significant impact on:

- the enjoyment of human rights as acknowledged in the UNGPs and OECD Guidelines and numerous EU initiatives, including the due diligence disclosure requirements in the Non-Financial Reporting Directive (2014/95/EU), the EU Timber Regulation (995/2010), the EU Conflict Minerals Regulation (2017/821) and public procurement directives; and

- the environment and climate change as recognised in the UN Framework Principles on Human Rights and the Environment, by reports of the UN Special Rapporteur on human rights and the environment, and elements of EU climate action and the European Green Deal.

The core fiduciary duties owed by directors are a duty of care, requiring a director to act with diligence, and a duty of loyalty, including with respect to avoiding conflicts of interest between the interests of the company and the interests of a director. Legal regimes articulate these obligations differently and typically impose other specific obligations on company directors, all of which are generally owed to the shareholders of a company. However, corporate governance approaches differ by jurisdiction. The three main categories are:

- a) a shareholder primacy approach under which a company owes obligations to its shareholders;
- b) a pluralist approach under which company owes a responsibility to a wider range of stakeholders as well as to its shareholders;¹³ and

- c) an “enlightened shareholder value” approach under which a company owes obligations to its shareholders with some consideration of other stakeholders.¹⁴

The model of “enlightened shareholder value” found in section 172 of the UK Companies Act,¹⁵ shares some similarities with the proposed corporate governance reforms being considered as part of the Sustainable Corporate Governance Initiative. The impact of s172 is therefore instructive when considering whether and how reforms to directors duties should be developed at the EU level.

Section 172 requires a director to act in a way “most likely to promote the success of the company for the benefit of its members as a whole” taking into account, inter alia, the “impact of the company’s operations on the community and the environment”, the “interests of the company’s employees”, “the need to foster relationships with suppliers, customers and others” and “the likely consequences of any decision in the long term”.¹⁶

¹³ Examples of the pluralist approach typically require a company to take employee interests into account and can be found in jurisdictions which include worker representation on the board. For example, in Austria and Germany. See also Polish Code of Commercial Companies

¹⁴ See Sarah Worthington, ‘Reforming Directors’ Duties’, 64 *Modern Law Review* 439 (2001).

¹⁵ See UK Companies Act, section 172

¹⁶ Section 172 of the UK Companies Act provides:

1) A director of a company must act in the way he considers, in good faith, would be most likely to promote the success of the company for the benefit of its members as a whole, and in doing so have regard (amongst other matters) to—

Directors have an obligation to consider the interests of other stakeholders in discharging their obligation to act in a way that promotes the success of the company and benefits its members. However, there are significant challenges in enforcing this obligation. These include the lack of an objective standard in assessing whether a director has taken a decision in compliance with s172, which instead involves the application of a subjective test. Further, although there may be limited circumstances in which a company officer could be personally liable to an employee for damage flowing from a breach of a directors duty,¹⁷ in general there is no clear mechanism by which affected stakeholders can seek a remedy for a breach of the obligations in s172.

Section 172 has been in force since 2006. However, there is little evidence that the

requirement to take into account the interests of a broader range of stakeholders or long term decision making has had a significant impact on the sustainability or human rights performance of UK companies. Rather, research has found serious deficiencies in respect for human rights by UK companies and serious ongoing violations.¹⁸

One explanation for the lack of significant impact of that section since its enactment in 2006 is the lack of enforcement mechanism. If a new or augmented directors duty is to be considered as part of this measure, a mechanism which give standing to affected stakeholders to enforce the requirements of such a duty by reference to an objective standard. Standing could be given to civil society groups or affected stakeholders to bring an enforcement action. Such an enforcement action could be modelled on a

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- (a) the likely consequences of any decision in the long term,
 - (b) the interests of the company's employees,
 - (c) the need to foster the company's business relationships with suppliers, customers and others,
 - (d) the impact of the company's operations on the community and the environment,
 - (e) the desirability of the company maintaining a reputation for high standards of business conduct, and
 - (f) the need to act fairly as between members of the company.
- (2) Where or to the extent that the purposes of the company consist of or include purposes other than the benefit of its members, subsection (1) has effect as if the reference to promoting the success of the company for the

benefit of its members were to achieving those purposes.

(3) The duty imposed by this section has effect subject to any enactment or rule of law requiring directors, in certain circumstances, to consider or act in the interests of creditors of the company.

¹⁷ See *Nerijus Antuzis & ors v DJ Houghton Catching Services Ltd & ors* [2019] EWHC 843 (QB) in which the directors of DJ Houghton were found to be liable for inducing breach of contract and failing to act in the best interests of the company by engaging in wage theft practices.

¹⁸ See BHRRC *Briefing: Is the UK Living up to its Business and Human Rights Commitments?* (2014) https://media.business-humanrights.org/media/documents/files/UK_Briefing_-_FINAL.pdf

shareholder derivative action commonly available in company law¹⁹ pursuant to which a shareholder may apply to the court to intervene and take action on behalf of the company where they consider that a director has breached their duties, including where a director has made a decision which puts the company at risk of violating a law, which could include a violation of a prospective due diligence duty. The threshold for bringing a stakeholder derivative action modelled on the shareholder derivative action could include requirements that the relevant stakeholder is acting in good faith, that the action sought in the intervention is in the best interests of the company, and that it would be unlikely that the company could take the action sought itself without intervention.

A lesson from the UK's enlightened shareholder approach is that a directors duty to have regard to the interests of a broad range of stakeholders alone is insufficient to ensure that a company identifies and addresses its human rights impacts, and facilitates access to effective remedy to rightsholders who are negatively impacted by the actions of a company.

Directors' duties are one way in which company directors can be held accountable for the negative impacts of a company.

¹⁹ See for example UK Companies Act 2006, Part 11; Australian Corporations Act 2001 part 2F.1A; and equivalent common law mechanisms

However, the problems of short-termism and undue focus on maximisation of shareholder value targeted by the Sustainable Corporate Governance initiative cannot be addressed solely by imposing a requirement on directors to have regard to sustainability and the company's long-term interest. In addition to Directors duties, any legal framework operationalising the Initiative must include a mandatory obligation on the company to undertake due diligence to identify and address human rights and environmental impacts with a focus on rightsholders.

A legally binding obligation on directors to take these stakeholder interests into account and set up adequate procedures to ensure that potential adverse effects on such stakeholders are identified, prevented, addressed and remediated would be welcome. However, an obligation on the part of directors to manage risks to the company that may arise in relation to stakeholders and their interests could potentially conflict with an obligation on the company to undertake human rights due diligence, through which a company identifies and addresses risks to rightsholders rather than risks to the company.

Any directors' duty should oblige directors to ensure that the company undertakes a

process of meaningful human rights due diligence which assesses the impacts that the company has on relevant rightsholders and prioritises action to address those impacts in accordance with the principle of severity which, consistent with the approach set out in the UNGPs, requires companies to assess the scale, scope and irredeemable character of an impact.

Directors should be subject to a legally-binding obligation to develop, disclose and implement action plans which identify and address adverse human rights and environmental impacts connected to the company's business model, operations and supply chain using a methodology aligned with the process of due diligence set out in the UNGPs. Human rights impacts should be identified and assessed having regard to the International Bill of Rights and the core ILO conventions, as well as other international human rights law instruments. Science-based targets are relevant to the environmental and climate related agendas, however on human rights there can still be measurable principles based targets and metrics. Work on this in the context of the EU Sustainable Finance Disclosure Regulation (2019/2088) and Social taxonomy should be consulted as to maximise synergy between measures.

OTHER MEASURES

- **Consistent with the smart mix, the EU should evaluate how to make its trade policy, public procurement measures,**

and sustainable finance measures mutually reinforce a proposed sustainable corporate governance initiative

- **The EU should meaningfully engage with the process to introduce a binding treaty on business and human rights**

The EU should examine whether trade agreements, measures relating to EU market access and other international cooperation agreements may be used to further promote respect for human rights and facilitate a level playing field.

EU development policy can be leveraged to promote respect for human rights by business in third countries, including by funding NGOs through the grant modality to monitor and engage with business; by requiring businesses in receipt of private sector support to respect human rights; and by leveraging the business and human rights agenda through the provision of budget support to third country states.

In line with the EU's 2015 [Trade for All](#) and 2017 [Aid for Trade](#) strategies, trade instruments can be an effective tool to promote respect for human rights by business and implementation of UN human rights conventions as well as the ILO Core Conventions. The Commission and the ILO have a longstanding partnership on supporting EU trading partner countries jointly to improve the application of the ILO Fundamental Conventions, including through

the [Trade for Decent Work Project](#) which could be leveraged. The EU should explore means of linking requirements regarding sustainable governance to its trade strategy to identify means of mutually reinforcing requirements for responsible business conduct.

Through [GSP+](#), countries who have ratified and effectively implemented 27 international conventions on human rights, labour rights, environmental preservation and good governance can gain preferential EU market access. When coupled with continuous engagement with the local authorities through dialogue, projects and EU Delegation contacts, GSP+ is another tool that should be leveraged to promote responsible business conduct aligned with sustainable development and generate a level playing field.

The EU has included commitments to promote responsible business conduct into all its recently-concluded free trade agreements. The sustainable development chapters and specific responsible business conduct commitments provide a basis for engagement on respect for human rights by third country businesses. From 2009, New Generation Agreements signed by the EU include dedicated chapters on Trade and Sustainable Development. In these chapters, the EU and its partner countries commit to respecting a number of international conventions for labour standards and environmental

preservation. The EU should monitor and facilitate compliance with these obligations and take steps when commitments are not met.

The EU should further support actions in connection with other EU Regulations linked to EU market access which touch on human rights, including the EU's Conflict Minerals Regulation.

In addition, the EU can take steps to ensure that public procurement mechanisms include procurement criteria requiring companies to respect human rights and the environment, and favour suppliers that have human rights and due diligence processes.

The EU should also secure a mandate to engage with the process for adopting a binding treaty to regulate the activities of transnational corporations and business enterprises.

Finally, the EU's sustainable finance policies might also help to drive a market push for respect for human rights by companies including outside of the EU. However, if this is to happen, it is key that the inclusion of human rights aspects in the Sustainable Finance Disclosure Regulation (2019/2088) as well as in the continuous work on the taxonomy, including in the context of a social taxonomy, ensures maximum alignment with the UNGPs and thereby avoids administrative burdens and patchwork regulation issues.

Each of these levers contributes to the smart mix of measures envisaged by the UNGPs to ensure respect for human rights by business.

ADDRESSING POTENTIAL DRAWBACKS

The potential drawbacks of a mandatory measure identified in the Consultation are not all material, can all be managed in the context of a well-designed mandatory due diligence measure and should not keep the EU from moving forward with the initiative.

- Increased administrative costs and procedural burden: There may be up-front costs and burdens for businesses establishing due diligence measures. However, as the DG JUST Study has found, the costs of carrying out supply chain due diligence are relatively low compared to the company's revenue. Not undertaking due diligence means a business is not addressing the risk of human rights abuses and environmental harm. In addition to costs and burdens for the victims, these risks may bring costs and burdens for businesses related to: i) reputational costs; ii) legal costs (including incurring liability for human rights harms); and iii) financial (eg, costs associated with delays in contract delivery, remediating harms, or divestment on grounds of ESG criteria). If addressed effectively, some of these may become opportunities. A business that

takes effective steps to respect the human rights of workers may be viewed more favourably by customers and investors, which can more than offset any up-front costs.

- Penalisation of smaller companies: The responsibility to conduct due diligence is the same for all businesses, regardless of size. However, as the UNGPs note, what is expected of businesses to meet this obligation varies depending on their size. As a result, implementing due diligence in an SME context is most often much less resource intensive than the same endeavor in an MNE context. A due diligence duty, properly implemented with support from the state, should not be a disproportionate burden for SMEs.
- Competitive disadvantage: A horizontal, cross sectoral measure applicable to all businesses will facilitate a level playing field. Requiring third country companies who provide goods and services on the single market to comply with the same obligations as EU companies will mean that EU companies will not be at a competitive disadvantage. By imposing a mandatory due diligence requirement, companies trading with or supplying EU companies will be encouraged to undertake due diligence by their EU business partners, thereby driving change in non-EU companies as well.

- Responsibility for damages: While much depends on the design of the measure, liability is normally determined in accordance with the level of control or influence of the company over the relevant subsidiary or business partner. Undertaking adequate due diligence can operate as a defence enabling companies to prove they took all due care to avoid the harm in question or that the harm would have occurred even if all due care had been taken.
- Decreased attention to core corporate activities: The OECD study [Quantifying the Costs, Benefits and Risks of Due Diligence for Responsible Business Conduct](#), which analysed the compliance costs of due diligence mechanisms and the economic benefits for businesses of responsible business conduct, found positive outcomes from comprehensive due diligence, including: outperformance in stock price, increased returns, reduced volatility, improved investor satisfaction, increased ability to attract and retain talent, reduced turnover, recruitment and training costs, and improved reputation. The 2020 DIHR study, [Doing Well by Doing Right?](#) also found that there is a basis for a business case for respecting human rights.
- Difficulty for buyers to find suitable suppliers: As clearly underlined in the UNGPs and the OECD Due Diligence

Guidance, due diligence should be progressively realised. The aim of including human rights and environmental due diligence requirements within procurement is not to exclude potential suppliers, but to effectively encourage suppliers to continuously increase respect for human rights. An EU Regulation should be expected to drive a market push in this direction, making human rights due diligence a relevant parameter.

- Disengagement from risky markets: Disengagement should be the last step. Before resorting to disengagement, a business can turn to other measures such as dialogue or stopping work and suspension of a contract or supplier in the risky market. Subsequent steps can include an investigation and, if human rights abuses are found, a requirement for a formal process to remedy human rights abuses and prevent reoccurrence, including through the development of an action plan. The EU can also mitigate the potential for disengagement by supporting partner countries through development cooperation to address systemic human rights and business issues and promote respect for human rights by third country businesses.