PUTTING DUE DILIGENCE AT THE HEART OF SUSTAINABLE BUSINESS

EVENT REPORT | MARCH 2021

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The European Commission is set to table a draft law by the end of June that will require companies to ensure that their supply chains are free of human rights and environmental abuse and corruption. That follows years of campaigning by EU lawmakers and civil society groups, and a shift in attitude from much of the business community.

However, questions remain as to what should be in the law, the firms that will be affected and the issue of sanctions, to name just three. This event report looks at what is likely to be in the legislation and the challenges ahead.
New EU reporting requirements will force firms to ‘get serious’

EU chance for ‘Brussels moment’ on human rights reporting, says leading lawmaker
The European Commission will force companies to “get serious” about due diligence and non-financial reporting as it prepares to table key legislation in the coming months.

“Responsible reporting is clearly part of responsible business,” said the EU’s financial stability Commissioner, Mairead McGuinness. “We are not doing this to impose new burdens on companies but to ensure that our companies are sustainable,” she added.

The EU executive will ensure coherence between new corporate due diligence legislation and the revised non-financial reporting directive to increase companies’ accountability, McGuinness and Justice Commissioners Didier Reynders said at a webinar on Monday (15 March).

“My colleague Commissioner Reynders and I work together to build a consistent framework on corporate reporting, and on sustainable corporate governance,” said McGuinness.

“We’ll ensure that there is coherence between the two proposals, and we continue to make sure that throughout the legislative process with the Council and Parliament we keep that coherence in mind,” she added.

This year the EU is tightening its legislation to expand corporate due diligence requirements, revising the non-financial reporting directive and drawing together a list of green finance criteria, known as the EU taxonomy.

Reynders has promised to table the due diligence legislation in June.

The aim of the bill, which is the product of a decade of campaigning by EU lawmakers and civil society, is to create legal certainty and increase environmental and human rights protection across European supply chains.

The draft law is expected to take account of all internationally agreed human rights conventions and agreements on environment and governance, including corruption. Companies are set to be required to look at all possible adverse impacts

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on human rights, environment and governance across the whole of their value chain.

They will then need to mitigate, prevent and remedy any failures and breaches, or face possible sanctions if they fail to do so.

Time is running out, said Heidi Hautala, one of the shadow rapporteurs on the European Parliament’s recent report on due diligence and co-founder of the Responsible Business Conduct Working Group, pointing to the need to have environmentally sustainable business.

“These and other global challenges cannot be solved without full engagement for the private sector and alongside other sectors,” she added.

Last week, EU lawmakers endorsed a report by Socialist MEP Lara Wolters calling on the Commission proposal to increase access to justice for citizens in third countries.

“I think that the sort of mainstreaming effort there that we have to do together is only just getting started,” said Wolters.

EU lawmakers say there has been a shift in attitude among many companies, which now support due diligence laws, citing consumer and client demand for ethical business practices.

“We need to be able to distinguish the companies that are serious from those that just say they are serious,” added Wolters.

CORPORATE DUE DILIGENCE

Under the proposal, due diligence requirements would be proportional to companies’ size and resources, but those operating in riskier sectors would need to do more.

One controversial question which remains unanswered is whether and how small firms would be included in the scope. Reynders said the EU executive was still looking at ways to give small businesses financial and technical support so that they have the resources to be able to comply.

MEPs have called for EU budget lines to be used to provide financial support to small firms.

For his part, Axel Voss, spokesman on the due diligence file for the centre-right European People’s Party, suggested that a sector-specific approach could be a more effective way of targeting the companies with greater risks in their supply chains.

The Commission is also examining the rules for third countries and enforcement and liability, a tricky issue since judicial competences typically lie in the hands of member states.

Part of the logic behind the planned legislation is that it will create a level playing field and harmonise rules following a range of laws and voluntary schemes covering modern slavery, child labour and supply chains in a handful of EU states including the Netherlands, France, and, in the coming months, Germany.

The Commission is working on an impact assessment and analysing the almost half a million responses from the public consultation.

“The Commission strives for a horizontal legislative initiative on sustainable corporate governance at the European level, in view of supporting a fair and sustainable transition in the economy,” Reynders said.

“EU companies should make all reasonable efforts to make sure that practices against human rights, labour and social rights that are not tolerated within the union do not take place in their supply chain,” he added.

NON-FINANCIAL RISKS

The non-financial reporting directive (NRFD) is also up for revision this year to reflect the EU’s increased climate ambition. It will look to strengthen the rules without imposing unnecessary burdens on SMEs.

“it’s no good saying what you’re doing, we need to be able to verify that that is the case,” said McGuinness, adding that data will need to be audited and verified.

“Sustainability is not integrated enough into our financial and our economic systems, and I think it’s a lesson we should do well to learn as we adapt to mitigating the effects of climate change and indeed environmental and biodiversity and other issues,” she said, warning risks will only grow as climate change worsens.

Julia Linares from WWF said the Commission must ensure coherence and consistency between legislation and include clear climate targets.

“Without a target, companies will not deliver randomly,” she added, saying the taxonomy could act as a guide but is not a complete solution.
The European Commission is set to propose legislation making it compulsory for companies to ensure that their supply chains are free of human rights and environmental abuse and corruption. And the direction of the debate among national and EU lawmakers, and among companies, is only going one way, says MEP Heidi Hautala.

Nearly ten years after the Commission promised an action plan on business and human rights, the EU is on the brink of passing legislation requiring companies to be strict about ethical aspects of their business.

Last week, the European Parliament adopted a report by Socialist lawmaker Lara Wolters setting out its demands for the law which Justice Commissioner Didier Reynders has promised to table by the end of June.

“The Wolters report sent a good signal,” said Hautala, who is the Green group’s spokesperson on due diligence and human rights reporting and founder of the Parliament’s working group for Responsible Business Conduct.

She praised Wolters’ for “a tremendously good job” on the file.

“It contains all the essential elements that I believe need to be
in this legislation,” Hautala told EURACTIV, noting that the EU now has a chance to set the international standard for due diligence reporting.

“I’ve heard many people say that ‘We’ve had a GDPR Brussels moment and maybe we will have a due diligence Brussels moment’. Companies from all over the world that want to operate in the EU internal market will have to adapt to these due diligence requirements. There is a grand scheme ahead of us,” she said.

Hautala also pointed to the review of the non-financial reporting directive currently being overseen by Financial Services Commissioner Mairead McGuiness.

“Our thinking has evolved over the last few years. Now it is understood that non-financial reporting means sustainability, covering social, environmental and governance, and needs to be put on the same level as financial reporting and accounting,” she said.

One of the dynamics on due diligence in recent years has been the growing number of companies calling for due diligence laws.

“I’m aware that some business associations are still sceptical,” Hautala said but added that “we see that many companies are now saying that they need a level playing field”.

“They need European regulations because there has been a mushrooming of different national standards,” said Hautala, pointing to laws in the Netherlands, UK and France, while the German government is also preparing national legislation.

“Companies say that we need a market-wide regulation, and the second aspect of the level playing field is that they don’t want to be outcompeted by irresponsible companies.”

Hautala pointed to the growth of sustainable fashion and to the cocoa industry, where there have been recent cases of former child labour cocoa workers in West Africa taking the companies to court.

“Companies are realising that the accountability will be there and that they had better be proactive,” she remarked.

**SCOPE AND LIABILITY QUESTIONS**

There are still plenty of open questions about the scope of the upcoming due diligence law and what will be in it. The Parliament report would see all large companies, as well as listed SMEs and those non-listed SMEs that operate in high-risk areas being covered.

“The basic idea is that companies will look at their whole value chain and identify the most urgent and serious risks and impacts on human rights, environment and governance. Once they discover issues they need to mitigate, prevent and, importantly, remedy those failures and breaches,” Hautala said of the likely scope of the new law.

“At the end of the day, companies will only be made liable if they cannot prove that they have done everything that is in their capacity to discover, prevent and mitigate those failures,” the lawmaker added.

Another tricky question is how to ensure that victims, typically in countries outside the EU, can have access to justice.

Currently “it is very difficult for victims to get justice because the legal systems are national whereas global supply chains cross boundaries with considerable ease,” Hautala explained.

“There is a need to ensure access to justice for victims and lower the barriers to seeking legal remedy.”

Similarly, the question of what a sanctions regime would look like is also still being debated. “What we want in this instrument is to have is civil liability.”

“The options are a combination of civil liability and administrative sanctions and it’s open on how much we would be able to regulate this at the EU level and how much we would have to rely on administrative sanctions and civil liability regimes at the member state level,” she said, warning that “the transfer of judicial issues to the EU from member states is never easy”.

**SMALL BUSINESS CONCERNS**

One of the more contested provisions of the Wolters report is that its scope should also cover small businesses operating in high-risk sectors, and Hautala is mindful of concerns from business associations, particularly those representing small firms, that the reporting requirements will impose a heavy administrative burden on already stretched businesses.

“This has been a stumbling block and we need to find solutions that will make it easier for small businesses

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to adapt to these rules, but I think it’s completely doable,” she says, pointing to the possibility of using the EU budget to help support SMEs to cope with the legislation.

**CHANGING ATTITUDES**

The journey to get a draft law has taken the best part of a decade, and there are concerns that divisions among national governments could prolong it further.

However, the Green MEP is optimistic that the debate is only going in one direction, citing a rapidly changed approach from the European Commission.

“What has been really interesting is that DG Trade is looking into this because they realise that there are a couple of very problematic trade deals on the table, Mercosur and the investment agreement with China. In both cases, there are serious issues around human rights and deforestation.”

“This is something that the EU can legislate on, and it could have a very strong impact on some of the problematic issues which we find in some of our trade deals,” she said.
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