

Supply Chain due diligence

Charlotte Villiers, University of Bristol

Introduction

- Complex corporate and organisational arrangements and global supply chains often opaque.
- Information is required to challenge companies' behaviours
- Reporting and transparency have for a long time been the predominant means to seek to hold corporations to account for their impacts but often such reporting is inadequate and does little to prevent or reduce harmful impacts.
- Due diligence offers a more proactive approach
- A strong shift towards due diligence, especially within Europe, and this is encouraged as part of the European Sustainable Finance Agenda.
- Will due diligence make a positive difference?
- What are the risks of inaction?

Supply chains – structural complexity

- Many industries, including manufacturing, the energy industry, the agri-food industry, and a myriad of financial and business services.
- Global value chain trade has accounted for 60–67 per cent of global trade in value-added terms (WTO, 2017) and more than 450 million people work in supply chain-related jobs (ILO, undated).
- Fragmented production, multiple layers of suppliers (could be 50 layers deep), fluid and dynamic arrangements – consequences is: horizontal, vertical and spatial complexities that interact and lead to uncertainties, production disruptions and regulatory challenges.
- Regulatory arbitrage, regulatory gaps, corruption, human rights violations.
- Complex challenges for basic questions of positive legal analysis, including matters of territorial jurisdiction, governing law, private regulation through contract and sovereign authority (Global Law and Policy Working Group, 2016)

Reporting as a regulatory response to the supply chain risks

A myriad of different behavioral and reporting requirements, international and national.

Some examples:

Global Compact Ten Principles for Responsible Business Conduct (voluntary), Global Reporting Initiative (voluntary), UN GPs on Business and Human Rights (2011) OECD Guidelines for Multinational Enterprises, EU Non-Financial Reporting Directive (2014); UK Section 414 Companies Act and subsequent secondary legislation, Modern Slavery Act 2015, Australia Modern Slavery Act 2018, California Transparency in Supply Chains Act 2010.

Reporting is justified as 'regulation by revelation': greater trust, more participation, a more efficient administration and less corruption.

What is wrong with reporting?

A spaghetti soup of reporting requirements – variety of different reporting regimes – some voluntary, some mandatory

Proliferation of measures may compete with or contradict each other,

Lack of consistency and comparability

Commodification of information, (an industry, intermediaries and power brokers, auditors' fees...)

Power reinforcement (who holds the information and who receives it? Lead firms seize control)

Information overload (too much information overwhelms)

Lack of enforcement or remediation (no consequences for poor information requirement compliance)

Doesn't necessarily lead to behavioral change

why due diligence and what is it?

Due diligence seen to be potentially an advance on reporting because it requires a practical response from a company that identifies negative impacts.

Four essential components of HRDD: (1) assessing actual and potential human rights impacts; (2) integrating and acting upon the findings; (3) tracking responses; and (4) communicating how impacts are addressed

Elaborated upon in UNGPs Principle 17: commentary makes clear that “potential impacts should be addressed through prevention or mitigation, while actual impacts – those that have already occurred – should be a subject for remediation”. Principles 18-24 provide more detail on the different elements of HRDD.

Smit et al: provide a picture of the different HRDD actions that may be included: responsible contractual provisions and supplier codes and training, social auditing and proactive Multi-Stakeholder Initiatives, audits, investigations, training and grievance mechanisms for HRDD. Human Rights Impact Assessments often integrated into existing risk management processes – may assist in mainstreaming human rights into existing corporate practices and structures

origins of due diligence

- UN General Principles on Human Rights Three Pillars: three pillars: the State duty to protect against human rights abuses by business enterprises; the corporate responsibility to respect human rights; and the right of access to effective remedy for victims of human rights abuses.
- UNGP 15 states that business enterprises should have in place '[a] policy commitment to meet their responsibility to respect human rights'; '[a] human rights due diligence process to identify, prevent, mitigate and account for how they address their impacts on human rights'; and '[p]rocesses to enable the remediation of any adverse human rights impacts they cause or to which they contribute'.
- OECD Guidelines for Multinational Enterprises: revised in 2011 to take into account the UNGPs, the revisions introducing standards on human rights, due diligence and supply chain responsibility
- OECD, Due Diligence Guidance for Responsible Business Conduct (31 May 2018)
- OECD Due Diligence Guidance for Responsible Supply Chains of Minerals from Conflict-Affected and High-Risk Areas in 2011
- OECD Due Diligence Guidance for Responsible Supply Chains in the Garment and Footwear Sectors in 2017
- OECD and UN Food and Agriculture Organization, Guidance for Responsible Agricultural Supply Chains in 2016

some areas where law and practice has developed (eg Human Rights)

- French LOI n° 2017-399 du 27 mars 2017 relative au devoir de vigilance des sociétés mères et des entreprises donneuses d'ordre (1) [JORF n°0074 du 28 mars 2017](#)
- German Supply Chain Due Diligence Act 2021: Sorgfaltspflichtengesetz at <https://www.bmas.de/DE/Service/Gesetze-und-Gesetzesvorhaben/gesetz-unternehmerische-sorgfaltspflichten-lieferketten.html>
- Dutch Child Labour Due Diligence Law 2020 [*Wet Zorgplicht Kinderarbeid*] (the **Law**), due to come into effect in mid-2022
- Switzerland - Amendments to section 964 Swiss Code of Obligations to include new non-financial reporting obligations and due diligence requirements relating to child labour and handling of conflict minerals
- Norway Act on business transparency and work with fundamental human rights and decent work (Proposition 150 L (2020-2021), also known as the Transparency Law), adopted by Parliament June 2021.

EU plans for a new sustainability reporting directive – proposal adopted April 2021

- Part of the Sustainable Corporate Governance Initiative:
- Plans to revise the NFRD with introduction of a more comprehensive Corporate Sustainability Reporting Directive
- Will cover more companies, from approximately 11,000 to nearly 50,000.
- Concept of “double materiality perspective” (internal and external impacts) is taken further – that is companies have to report on the impact of their business activities on people and the planet across the full value chain, as well as the sustainability risks for the business itself, and to disclose the process for determining their material issues. Outside-in: how sustainability issues affect their performance, position and development., Inside-out: their impact on people and the environment.
- Measurements of sustainability via new general EU-wide audit (assurance) requirement for reported sustainability information aims to achieve more consistent, reliable, and therefore comparable information for investors and other stakeholders.
- Just gone through discussions in EU Council and goes next to European Parliament - expectation is that these measures will take effect in 2024, i.e. reporting on the financial year ending 2023.
- Taxonomy Regulation 2018, Taxonomy Climate Delegated Act adopted 2021 – clarifies disclosures required for climate change related activities.

EU plans for a new due diligence and corporate accountability law

- Part of the Sustainable corporate governance initiative:
- Introduces a new corporate duty for human rights and environmental due diligence, meaning that companies must take measures to address their adverse sustainability impacts, such as “harm in their own operations and in their value chain by identifying and preventing relevant risks and mitigating negative impacts (due diligence duty). Aims to build on existing authoritative guidelines (UNGPs and OECD). Remedy would also be part of this duty.
- Reform directors’ duties, to include sustainability matters in directors’ acts that “take into account all stakeholders’ interests which are relevant for the long-term sustainability of the firm, or which belong to those affected by it (employees, environment, other stakeholders affected by the business, etc.)” and integrate stakeholders’ interests into the corporate strategy.
- European Commission proposal was scheduled for publication in June 2021 but was postponed to end October. Debate likely to extend to 2022.

European Parliament Resolution

- European Parliament is advocating a Directive to include a new corporate duty relating to due diligence on human rights, environmental and governance issues, in line with the United Nations Guiding Principles (UNGPs). The Resolution was adopted in March 2021
- Proposes a binding due diligence duty for companies that have to identify, address and remedy situations in the value chain that could cause or contribute to human rights, environmental or good governance harm. These include social, trade unions and labour rights, contribution to climate change, and bribery.
- value chain due diligence obligations of undertakings under its scope, namely, to take all proportionate and commensurate measures and make efforts within their means to prevent adverse impacts on human rights, the environment and good governance from occurring in their value chains, and to properly address such adverse impacts when they occur”.
- sanctions to be effective, proportionate and dissuasive and that take into account the severity of the infringements committed and whether or not the infringement has taken place repeatedly - could include excluding undertakings from public procurement, state aid, public support schemes and loans.

Draft Treaty on Business and Human Rights

- Draft treaty on business and human rights statement endorses human rights due diligence

strengths and weaknesses

- Research evidence at EU level indicates that due diligence is likely to result in reductions in negative impacts
- aspirational quality of due diligence rules means that what constitutes real compliance is unclear; 'there is no single answer' to how businesses should conduct human rights due diligence and it is likely to 'vary greatly with different contexts'.
- Ultimately, corporations retain significant freedom to conduct their due diligence in ways that remain compatible with their commercial interests, potentially at the expense of more far-reaching improvements.

Could HRDD be a defense against negligence claims?

- Due diligence could become a defence for corporations against claims of negligence vis-à-vis human rights abuse, as has been mooted in some quarters.
- A warning: Baars (2017) warns of the risk that the consequent delegation of responsibility and compliance system could lead to lower ranking workers being blamed where non-compliance occurs, rather than the senior managers or the corporation. “The result could be that capital protects itself in the face of mechanisms formulated to restrain it—amounting to ‘planned impunity’ for the corporate ‘structure of irresponsibility’ as due diligence becomes a defence rather than a liability.”
- Draft Treaty that ‘human rights due diligence shall not automatically absolve a legal or natural person conducting business activities from liability for causing or contributing to human rights abuses or failing to prevent such abuses by a natural or legal person’ and that ‘the court or other competent authority will decide the liability of such entities after an examination of compliance with applicable human rights due diligence standards’.

what if companies fail to conduct due diligence and carry on as usual?

- Sjaafjell's paper on financial risks of unsustainability (2020) seeks to provide a basis for further debate on what might be the risks to people, planet and organisations if corporate practices do not stay within planetary boundaries and social foundations. Eg climate change, biodiversity, and novel entities as well as human rights violations, lack of decent work, tax evasion:
- Transition risks= Policy risk, Liability risk, Reputation risk, Market risk, Technology risk, Business model change risk
- Physical risks= Acute risks, Chronic risks, Global catastrophic risks
- Societal risks= Risk of unrest, Risk of authoritarianism, Societal breakdown risk

Conclusions

- Supply chains are often complex and opaque, with ability to hide exploitative or harmful practices
- Despite many reporting and disclosure requirements these have not necessarily changed or improved corporate practices
- Growth of due diligence legislation and sustainability initiatives
- Due diligence legislation may be an advance on reporting and is stronger than voluntary measures, requiring more proactive and responsive vigilance from the corporate actors;
- With due diligence firms must probe their internal structures and processes to dig out and minimise or prevent potential negative impacts on people from their business operations throughout their networks.
- Need to ensure that managers – and not lower ranked workers – are held responsible for adverse impacts and that HRDD does not let them off the hook.
- Business as usual is not an answer

Key Readings

- Villiers, C. (2019) 'Global supply chains and sustainability: the role of disclosure and due diligence laws' in *The Cambridge Handbook of Corporate Law, Corporate Governance and Sustainability* (pp. 551-565) Cambridge University Press.
- Smit, L., Holly, G., McCorquodale, R., & Neely, S. (2021) 'Human rights due diligence in global supply chains: evidence of corporate practices to inform a legal standard', *The International Journal of Human Rights*, 25(6), 945-973.
- UN Guiding Principles on Business and Human Rights: 2011 at https://www.ohchr.org/documents/publications/guidingprinciplesbusinesshr_en.pdf
- OECD Due Diligence Guidance for Responsible Business Conduct, 2018, at <http://mneguidelines.oecd.org/OECD-Due-Diligence-Guidance-for-Responsible-Business-Conduct.pdf>
- LOI n° 2017-399 du 27 mars 2017 relative au devoir de vigilance des sociétés mères et des entreprises donneuses d'ordre (1) [JORF n°0074 du 28 mars 2017](#)
- German Supply Chain Due Diligence Act 2021: Sorgfaltspflichtengesetz at <https://www.bmas.de/DE/Service/Gesetze-und-Gesetzesvorhaben/gesetz-unternehmerische-sorgfaltspflichten-lieferketten.html>
- European Parliament Briefing, Towards a mandatory EU system of due diligence for supply chains, October 2020, at [https://www.europarl.europa.eu/RegData/etudes/BRIE/2020/659299/EPRS_BRI\(2020\)659299_EN.pdf](https://www.europarl.europa.eu/RegData/etudes/BRIE/2020/659299/EPRS_BRI(2020)659299_EN.pdf); European Parliament resolution of 10 March 2021 with recommendations to the Commission on corporate due diligence and corporate accountability ([2020/2129\(INL\)](#) text adopted 10 March 2021
- Sjøfjell, Beate, 'The Financial Risks of Unsustainability: A Research Agenda' (June 29, 2020). University of Oslo Faculty of Law Research Paper No. 2020-18, Nordic & European Company Law Working Paper No. 21-05, Available at SSRN: <https://ssrn.com/abstract=3637969>