

February 8, 2021

## **MANDATORY CORPORATE HUMAN RIGHTS DUE DILIGENCE: WHAT NOW AND WHAT NEXT? AN INTERNATIONAL PERSPECTIVE**

To Our Clients and Friends:

### **Part One: EU Developments**

#### **Introduction**

The concept of mandatory corporate human rights due diligence is gaining momentum, both within Europe and on the international stage

In this two-part alert, we examine key global legislative developments and proposals on this important topic. In Part One, we look at very recent steps taken by the institutions of the EU towards implementation of legislation at a pan-European level. In Part Two, we will consider developments at a national level within the EU and also look beyond Europe as we discuss the position in APAC, the US and Canada.

#### **Mandatory Corporate Human Rights Due Diligence: EU Developments**

What exactly should be the responsibilities of directors and companies with regard to sustainability and mandatory human rights due diligence? That question has been high on the agenda at European level for some time, with both the European Commission (the executive branch) (the “**Commission**”) and the European Parliament (the legislature) (the “**EU Parliament**”) advocating strongly for legislation that would provide for mandatory corporate due diligence on human rights and environmental issues. Most recently, on 27 January 2021 the EU Parliament Committee on Legal Affairs (the “**CLA**”) adopted a draft report containing a proposal for a directive on Corporate Due Diligence and Corporate Accountability (the “**draft directive**”).

#### ***Background***

In April 2020, a few months after more than a hundred civil society organisations had called on the Commission to develop human rights and environmental due diligence legislation, EU Justice Commissioner Didier Reynders announced that the Commission would (by early 2021) propose a law requiring corporates to undertake mandatory environmental and human rights due diligence across their supply chain and business relationships.

In July 2020, the Commission then published a study that focused on the root causes of “*short termism*” in corporate governance. Among those causes were, in the Commission’s opinion, a narrow view of directors’ duties, board remuneration that focused on short-term shareholder value, and the lack of a strategic perspective over sustainability. The study concluded that non-financial reporting obligations

*“have proven insufficient to overcome pressures to focus on short-term financial performance and to influence companies and their investors to prioritise sustainability.”[1]*

Since these announcements, both the Commission and the EU Parliament have considered several legislative initiatives, which are the focus of this alert:

- On 2 September 2020, Commissioner Reynders announced the Commission’s intention to submit a proposal for a mandatory human rights and environmental due diligence and sustainable corporate governance framework in 2021. The initiative would aim to impose on directors **an obligation to consider the interests of all stakeholders** (and not just the interests of the company’s shareholders).
- On 11 September 2020, the CLA published a report containing the draft directive. Both the report and the draft directive focus on **mandatory human rights, environmental and governance due diligence throughout a company’s value chain**.

### ***The Commission’s Sustainable Corporate Governance Initiative***

The Commission has indicated that it will put forward a proposal for corporate governance legislation in Q1 2021. The Inception Impact Assessment (a plan prepared by the Commission which sets out preliminary ideas for the initiative and allows for stakeholder feedback) indicates that measures could include a combination of new due diligence obligations on companies, as well as a new duty on directors *“to take into account **all stakeholders’ interests** which are relevant for the long-term sustainability of the firm.”[2]* Those new duties would be supplemented by an appropriate facilitating, enforcement and implementation mechanism.

#### **The Commission: Next Steps**

- A public consultation launched on 26 October 2020 closed on 8 February 2021.
- The Commission plans to submit a proposal for a directive in Q1 2021, taking account of feedback during the consultation.

### ***EU Parliament Draft Directive on Corporate Due Diligence and Corporate Accountability***

As mentioned above, on 11 September 2020, the CLA published a report that included the draft directive on corporate due diligence and corporate accountability. As things stand, the draft directive, which was adopted (with significant amendments to the September 2020 version) by the CLA on 27 January 2020, provides the best indication of what mandatory due diligence legislation might look like at EU level. While it is by no means final, the draft directive contains important considerations for businesses. This alert also considers the Compromise Amendments to the draft directive, which reflect the outcome of the CLA’s consideration of the report and the amendments published on 27 January.[3] A consolidated version of the report and accompanying revised draft directive are still awaited.

## The Draft Directive: Key Points

- **The obligation of due diligence: undertakings** should be **under an obligation** *“to identify, assess, prevent, cease, mitigate, monitor, communicate, account for, address and remediate the potential and/or actual adverse human rights, environmental and good governance impacts that their own activities and those of their value chains and business relationships may pose.”*
- Due diligence is moved **away from a “tick box” exercise** towards a **mandatory, meaningful, and ongoing obligation**.
- Due diligence should apply to a company’s own activities and **those of its value chains (both upstream and downstream) and its business relationships (including suppliers and sub-contractors)**.
- Companies should be required to:
  - **undertake a risk assessment and implement a due diligence strategy** (proportionate to the company’s size and level of risk);
  - **conduct an annual review** of the risk assessment and due diligence strategy; and
  - **provide grievance mechanisms and remediation processes** in connection with a **potential or actual** adverse human rights, environmental or good governance impact.
- As to directors’ duties: it is notable that the September 2020 version of the draft directive included a provision which imposed liability on members of administrative, management and supervisory bodies for breaches of due diligence duties. However, **this provision was removed from the January 2021 version adopted by the CLA**.
- Due diligence obligations would apply not only to **undertakings established in the EU**, but also to those **established outside the EU but selling goods or providing services in the EU**.
- Member States would be required to:
  - implement rules to **ensure that companies carry out effective due diligence**;
  - designate **independent national competent authorities** responsible for the supervision of the application of the directive, and for the dissemination of due diligence best practices;
  - **implement a civil liability regime** under which companies can be held liable for any harm arising out of **potential or actual adverse impacts** on human rights, the

environment or good governance that they, **or undertakings under their control**, have **caused or contributed to by acts or omissions**. The regime should include a **rebuttable presumption in favour of the victim**, and so companies would have to prove that they did not have control over a business entity involved in the human rights abuse; and

- implement a **penalty regime**, including regulatory sanctions and administrative fines. Pursuant to the draft directive's recital, these could be "*comparable in magnitude to fines currently provided for in competition law and data protection law*". To put this into context, the UK competition regulator (the Competition and Markets Authority) may impose a financial penalty of up to 10% of the worldwide turnover of the undertaking concerned and in the case of the General Data Protection Regulation fines could be up to €10,000,000 or, in the case of an undertaking, up to 2% of its entire global turnover of the preceding fiscal year, whichever is higher.
- The provisions of the draft directive would be considered "mandatory provisions" under the Rome II Regulation (864/2007/EC), which means that the particular governing law applicable under Rome II may be overridden by any relevant provisions of the draft directive.

## The Draft Directive: Next Steps

- The draft directive is scheduled to be tabled at a Plenary Meeting of the EU Parliament on 8 March 2021.
- If adopted, it will then take the form of a request from the EU Parliament to the Commission, asking the Commission to submit a legislative proposal along the lines of the draft directive. Whether or not the Commission does so is a matter for the Commission's discretion.
- If the directive is eventually adopted by the EU, it would then need to be implemented into the national laws of Member States.

It is important to note that there is **no guarantee** that the Commission will submit a proposal for legislation in the form of the draft directive. Indeed, between 2009 and 2019, the Commission put forward a legislative proposal in respect of only 7 out of the EU Parliament's 29 legislative initiatives. While the Commission has expressed interest in this type of initiative (and, as explained above, is currently working on a similar initiative of its own), it may decide to make amendments to the draft legislative framework or simply propose its own framework. The future path of the draft directive in its current form is therefore by no means clear.

## ***Other EU Parliament Initiatives***

The developments just described feature among a whole suite of EU Parliament initiatives.

Other measures include a separate mandatory due diligence initiative focusing on forest and ecosystem-risk commodities (“**FERC**”). At the moment, this initiative is in the form of a report, which was adopted by the EU Parliament on 22 October 2020, and which requests that the Commission propose an EU legal framework to halt and reverse EU-driven global deforestation. The report contains recommendations, including that companies which place FERC on the EU market (or companies providing finance to such operators) should be required to conduct due diligence on their supply chains. In the case of non-compliance with the obligations proposed in the initiative, the report recommends criminal and civil penalties for individuals as well as for companies, irrespective of the company’s legal form, size, location or the complexity of its value chains.<sup>[4]</sup>

Further, on 17 December 2020, the EU Parliament approved a report on sustainable corporate governance.<sup>[5]</sup> The report does not put forward any legislative proposals but focuses on perceived shortcomings in the implementation of the Non-Financial Reporting Directive (“**NFRD**”), which governs the disclosure of non-financial and diversity information by large companies. The report invites the Commission to review the NFRD. The report calls for a new framework to introduce an enhanced director duty of care in company law, noting in particular that “*the duty of care of directors towards their company should be defined not only in relation to short-term profit maximisation by way of shares, but also sustainability concerns.*” The report also calls for additional measures to make corporate governance more sustainability-oriented. It “*considers that linking the variable part of the remuneration of executive directors to the achievement of the measurable targets set in the [company’s sustainability] strategy would serve to align directors’ interests with the long-term interests of their companies; [and] calls on the Commission to further promote such remuneration schemes for top management positions.*” The report is a way for the EU Parliament to exert pressure on the Commission to put forward a legislative proposal on corporate governance, and could also be an indicator that the EU Parliament will be supportive of the Commission’s corporate governance initiative.

## **Conclusion**

If the European initiatives become law in their current form, or in a similar form, they will impose substantive requirements on companies with an EU footprint, whether based in Europe or providing goods or services into the EU. The expectation that companies should conduct mandatory due diligence for environmental and human rights impacts may extend to a requirement to conduct that due diligence across the company’s entire value chain, with potential administrative fines and civil liability for failures which have led (or might lead) to adverse human rights impacts. While we understand that director liability has been removed from the draft directive, the Commission’s sustainable corporate governance initiative means that legal risks could still arise at both a corporate and director level.

However these initiatives evolve, when viewed with other national and international developments (to be discussed in Part Two of this alert), it is clear that companies proactively need to be considering their

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value chain management and risk management frameworks for human rights, environmental and good governance considerations, and readying themselves for stricter controls and expectations in this field.

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[1] Study on directors' duties and sustainable corporate governance (29 July 2020), available at: <https://op.europa.eu/en/publication-detail/-/publication/e47928a2-d20b-11ea-adf7-01aa75ed71a1/language-en>.

[2] Emphasis added. The Inception Impact Assessment for the Commission's Initiative is available at: [https://ec.europa.eu/info/law/better-regulation/have-your-say/initiatives/12548-Sustainable-corporate-governance\\_](https://ec.europa.eu/info/law/better-regulation/have-your-say/initiatives/12548-Sustainable-corporate-governance_)

[3] The September 2020 draft of the report is available at: [https://www.europarl.europa.eu/meetdocs/2014\\_2019/plmrep/COMMITTEES/JURI/PR/2021/01-27/1212406EN.pdf](https://www.europarl.europa.eu/meetdocs/2014_2019/plmrep/COMMITTEES/JURI/PR/2021/01-27/1212406EN.pdf). The amendments to the draft are available at: [https://www.europarl.europa.eu/meetdocs/2014\\_2019/plmrep/COMMITTEES/JURI/DV/2021/01-27/Votinglist\\_Corporateduediligence\\_amendments\\_EN.pdf](https://www.europarl.europa.eu/meetdocs/2014_2019/plmrep/COMMITTEES/JURI/DV/2021/01-27/Votinglist_Corporateduediligence_amendments_EN.pdf). As at the date of this article, a consolidated version of the draft report has not been published, but should soon be made available at: <https://www.europarl.europa.eu/committees/en/juri/documents/latest-documents>.

[4] Available at: [https://www.europarl.europa.eu/doceo/document/TA-9-2020-0285\\_EN.html](https://www.europarl.europa.eu/doceo/document/TA-9-2020-0285_EN.html).

[5] Available at: [https://www.europarl.europa.eu/doceo/document/TA-9-2020-0372\\_EN.html](https://www.europarl.europa.eu/doceo/document/TA-9-2020-0372_EN.html).



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