European Policy Options for Companies' Due Diligence through the Supply Chain

AFEP POSITION PAPER – FEBRUARY 2020

Large French companies have been engaged for many years in putting CSR at the heart of their strategies. They present the highest level of non-financial information compared to companies worldwide and have made strong commitments, notably to reduce their GHG emissions, to respect human rights, to preserve biodiversity and engage in the circular economy. They have a 15-years' experience in advanced non-financial reporting, and they apply the French Law on the Corporate Duty of Vigilance adopted in 2017[1].

Against this backdrop, large French companies can provide a legitimate and experience-based contribution to the Commission's preparatory work in the field of EU companies' due diligence through the supply chain. While being strongly committed to implementing CSR policies and due diligence practices through supply chains according to their values and commitments taken towards international guidelines and principles, they believe that punitive legislation is neither an appropriate nor an efficient approach.

Key messages

From the French companies' perspective, where a mandatory due diligence obligation coupled with civil liability has been introduced in 2017, the drawbacks of such legislation are clear, while the actual benefits are not yet demonstrated:

- The French Law on the Duty of Vigilance creates considerable legal uncertainty. The vagueness and extremely broad scope of the law may be a source of numerous, lengthy and costly judicial proceedings which would create a climate of distrust and rarely change the situation of local populations.
- UN and OECD guidelines are perfectly clear that due diligence does not shift responsibilities, either from governments to enterprises nor from suppliers or subcontractors to the companies placing the order. The EU should note that each State or company has its own responsibility for adverse impacts. Shifting the onus from third countries to EU companies will disincentivise third countries to improve human rights and social standards on their territory.
- Before envisaging any new due diligence measures, a thorough assessment of the effectiveness of already implemented rules (including the advanced Non-financial Reporting Directive n° 2014/95/EU and relevant national legislation) should be conducted. At this stage, it is clearly premature to envisage another layer, for example with a European mandatory due diligence coupled with civil liability.
- Existing French and European regulations are not efficient because they do not address the root causes of negative impacts on global supply chains, which lie in the competition and the disparities of legal frameworks outside the EU. They neither prevent imports from non-EU companies, which do not respect due diligence, from entering EU markets, nor do they mitigate negative impacts in third countries caused by international competitors who are less concerned with responsible business conduct than EU companies.
- EU companies frequently face dilemmas when operating in States in which protective laws are either not existing or not enforced. The European Commission should propose case studies

[1] The Law on the Corporate Duty of Vigilance (Law N° 2017-399, 27 March 2017) introduced the obligation for large companies, employing more than 5000 employees in France or more than 10 000 worldwide, to establish and implement a vigilance plan for the company's operations, those of its subsidiaries, as well as of subcontractors or suppliers with whom it maintains an established relationship. In case of failure to comply with the duties specified in the law, the company shall be liable and obliged to compensate for the harm that a vigilance plan would have permitted to avoid. The vigilance plan "shall include the reasonable vigilance measures in order to identify the risks and prevent severe impacts on human rights and fundamental freedoms, human health and safety, and the environment".

addressing these situations and providing **guidance** to EU companies, in full accordance with, and in order to promote internationally recognised standards such as the UN Guiding Principles on Business and Human Rights (UNGP) and the OECD Due Diligence Guidance for Responsible Business Conduct.

- If the Commission decided to issue **voluntary guidance on due diligence**, endorsing internationally recognised standards, they **should be drafted collaboratively with EU companies**. This could also be a good opportunity to clarify some uncertainties surrounding the complex issue of due diligence.
- The EU templates for the Trade and Sustainable Development (TSD) chapters under bilateral **Free Trade Agreements should be upgraded** to incentivise our trading partners to improve responsible business conduct (RBC) and CSR practices by their domestic companies and foreign-invested companies. AFEP supports the **use of sanctions in the event of non-compliance with FTAs, in particular with TSD chapters**, subject to competitiveness edge test before deciding on sanctions. This is the only way to ensure full-fledged enforcement of RBC and CSR over the supply chain, without undermining EU companies' competitiveness and EU jobs.

1. The challenge of implementing due diligence in highly complex global supply chains

Due diligence, as defined by the OECD, is the process through which a company identifies, prevents, mitigates and accounts for how it addresses actual and potential negative impacts of its activities.

With the advent of globalisation, the management of supply chains has become highly complex, involving a broad range of suppliers and sub-contractors, comprising **multiple tiers with hundreds or thousands of locations and individuals**. While offering expanded sourcing opportunities for companies, it also brings about huge challenges in identifying and managing possible adverse environmental or social impacts caused at different stages of the supply chain.

The difficulties for companies implementing due diligence are numerous:

- Implementing due diligence requires the **collaboration of many stakeholders** within, but also outside, the company: suppliers, sub-contractors, clients, investors, consumers, local authorities and communities… There is **no single blueprint for success** in overcoming the challenges linked to risk-mapping and managing the most salient risks. It is practically impossible to control every single part of the chain. Only joint efforts, for example at sectoral or multi-industry level, together with trade unions, international organisations and civil society can exercise enough leverage for change to happen.

- **Some suppliers are much "bigger" than their customers**, even if those are multinational companies, and/or **refuse to cooperate, to respond to investigations or audit requests**. In these cases, customers try to exercise leverage by dialogue and cross-sector initiatives, but it must be underlined that even large companies do not necessarily have leverage on larger suppliers in a dominant position, which may not be as concerned as themselves about preventing or reducing negative impacts.

- **Some suppliers are controlled or imposed by the States** in which EU companies operate. These suppliers may **refuse to cooperate or change their practices**, knowing that their customers have no other choice than to contract with them if they want to operate on the market. Again, the EU company alone will not be able to change this situation, but will rely on multi-stakeholder initiatives including other States or international organisations.

- Especially difficult situations arise in **failing or weakly governed States** in which protective laws, guaranteeing human rights or the protection of the environment, are either inexistent or not applied. In these cases, companies aim at applying higher standards, but they cannot replace States and their obligation to protect human rights and the environment.

- There is still **no global level-playing field with regard to responsible business conduct.** The gap is huge with numerous non-European companies. Global supply chains will not improve if only European companies – already advanced regarding CSR policies – take action.

- Companies may face **dilemmas between competing objectives regarding human rights and fundamental freedoms, human health and safety, and the environment.** While pursuing one objective and reducing negative impact for example on the environment, the negative impact regarding another objective may increase. Again, addressing these dilemmas requires broad cross-industry cooperation and the involvement of international organisations and local governments to apply minimum environmental, social and human rights standards (see point 3.3.).

2. The shortcomings of mandatory due diligence coupled with civil liability

From the French companies' perspective, mandatory due diligence leads to two major shortcomings: **excessive litigation** and the **judicialization** of the relationship with stakeholders on the one hand, and the creation of **competitive distortions** to the detriment of EU companies compared to companies from outside the EU on the other hand.

2.1. EXCESSIVE LITIGATION AND JUDICIALIZATION OF THE RELATIONSHIP WITH STAKEHOLDERS

Mandatory due diligence coupled with civil liability would lead to **excessive litigation** and the **judicialization of the relationship with stakeholders**:

- The **vagueness and by essence extremely broad scope** of a mandatory due diligence would be the source of **numerous, lengthy and costly judicial proceedings.** In particular, expertise would be required to determine whether damage occurring along the supply chain was actually caused by the lack of due diligence of the parent company of the company placing the order. Such year-long proceedings rarely change the situation of local populations.

- The **risk of reputational damage** and of **sanctions by the market** attached to **soft law is more effective than hard law and lengthy procedures**. It has proven a real incentive for progress and changes. The OECD National Contact Points ensure compliance with the OECD Guiding Principles for multinational enterprises by addressing complaints against companies operating from the 45 countries adhering to the Guiding Principles. They examine "specific instances" within **best timeframes** (often within a year) and may monitor the **follow-up of its recommendations** which ensures real changes in behaviour (and not only financial sanctions). Contact Points are not sufficiently known by all stakeholders and should be promoted.

- Mandatory due diligence would create a **climate of distrust and defensive behaviours**: on the one hand, EU parent companies or companies placing orders, who have to fear to be held liable for any positive commitment with regard to their supply chain, will become very cautious and stick to the baseline rules rather than engage trustfully in useful dialogue and cooperation; on the other hand, stakeholders will be encouraged to seize the court in order to punish EU companies, who are already applying high

environmental and human rights standards, rather than pushing the other parts of supply chains to adopt a more responsible business conduct.

- Mandatory due diligence would not only affect the large companies covered by its scope, but would immediately trigger a **massive and widespread administrative and financial burden at all stages of the supply chain**, the burden of which would paralyse in the first place the weakest companies in the supply chain, namely **SMEs and VSEs**.

2.2. COMPETITIVE DISTORTIONS FOR EUROPEAN COMPANIES AND DISINCENTIVIZATION OF THIRD COUNTRIES TO IMPROVE HUMAN RIGHTS AND SOCIAL STANDARDS

Mandatory due diligence at national or European level would create **massive competition distortions for EU companies with regard to their competitors from outside the EU** as it would neither prevent imports from non-EU companies, which do not respect due diligence, from entering EU markets, nor mitigate negative impacts in third countries caused by international competitors who are less concerned with responsible business conduct than EU companies.

- The French Law on the Duty of Vigilance **applies only to large French companies and not to foreign commercial organisations, public or private**, based outside France but operating on the French market.

- European companies are subject to Non-Financial Reporting Directive n° 2014/95/EU requiring all large listed companies in the EU to publish a **non-financial statement containing the description of implemented due diligence processes** relating to environmental, social, employee matters, respect for human rights, anti-corruption and bribery matters. Again, **competitors from outside the EU, regardless of whether they are public or private operators, are not concerned by this obligation** although they operate in EU markets.

- It would, therefore, be **unfair to hold only European companies liable** for damages occurring through global supply chains when it is technically impossible to fully control every single part of the chain and many other actors in third countries are involved.

- In addition to the double standards that would create unlevel playing in third countries between domestic companies, subsidiaries of non-EU companies and subsidiaries of EU companies, **mandatory due diligence at national or EU level would also convey a negative message for third countries as regards their own responsibility in improving the protection of human rights, safety, human health and social rights**. Since due diligence requirements would shift the onus on subsidiaries of EU companies, **third countries would be disincentivised to impose on domestic-owned companies higher standards and to conduct internal legislative and enforcement reforms to this end.**

3. Coherent guidance and case studies on due diligence are welcome

The Guidelines on non-financial reporting published by the Commission in July 2017 are very brief and hardly go into details as far as due diligence processes are concerned. **Additional guidance for companies at EU level would, therefore, be useful in order to clarify what is understood by this very complex concept and how due diligence can be undertaken by companies.**

If the Commission decided to issue guidance on due diligence, AFEP considers that the following conditions and principles should be met:

3.1 ENDORSEMENT OF INTERNATIONALLY RECOGNISED STANDARDS

New guidance should be fully in line with internationally recognised standards such as the UN Guiding Principles on Business and Human Rights (UNGP) and the OECD Due Diligence Guidance for Responsible Business Conduct. **European companies operating worldwide already refer to these standards** to conduct business in a responsible way. They are the result of a long process involving States and multiple stakeholders around the globe. It should absolutely be avoided to have different sets of standards to apply at European level as supply chains are clearly a global issue.

The EU could endorse these standards by issuing guidance and support for European companies operating in States where risks of negative impacts are particularly high. Endorsing international standards would further promote them, ensure the dissemination of their underlying principles, and **avoid creating competitive distortions between players outside the EU**.

In addition, the role of OECD National Contact Points should be highlighted and promoted. As mentioned here above in section 2.1., they are more efficient than lengthy judicial procedures and they offer a unique mechanism to ensure the implementation of OECD Guiding Principles.

Last but not least, initiatives like the Global Business Network on Forced Labour and Human Trafficking, set up by the ILO to help business address the challenges of forced labour and human trafficking in an increasingly complex global setting, or the ILO Child Labour Platform should be made better known to EU companies.

3.2 FLEXIBLE AND CONSTRUCTIVE APPROACH OF SOFT LAW

New voluntary guidance should ensure a flexible approach which takes into account the highly different situations companies are facing depending on their specific sector and the geographic areas in which their supply chains are located. There is **no one-size-fits-all approach to due diligence**. It is an ongoing, iterative process involving multiple procedures and stakeholders, which fully depends on the company's individual risk analysis.

AFEP's member companies have worked collectively for more than a year in 2017 to identify **best practices and key factors for success** in deploying due diligence processes in their own operations and through supply chains. Nevertheless, despite best efforts and best practices, managing risks through global supply chains is so complex that it cannot be tackled in a snap because it involves a great number of actors at different stages. It takes several years to carry out risk analysis and put in place the appropriate procedures, which **can still never guarantee a "zero risk" in supply chains**.

Practices will be deployed based on the **materiality principle**, meaning that they will be **focused on certain suppliers, representing most severe risks, according to the priorities that have been set** for action to mitigate these risks. Large multinational companies may have up to 100.000 direct suppliers. It is practically impossible and inefficient to deploy these practices with regard to all of these suppliers. Prioritising is key.

3.3 COLLABORATIVE DRAFTING WITH EU COMPANIES

New voluntary guidelines should be drafted in close cooperation with European companies operating worldwide in order to ensure that their needs are met, and their concerns duly considered.

Case studies should address situations like those of European companies operating in a country where equality between women and men is not recognised or where freedom of speech or the right to collective bargaining is prohibited. It would help companies to understand which precise rules are the ones to follow.

Other difficult situations to be addressed in guidelines could concern the **delicate balance between competing objectives** regarding human rights and fundamental freedoms, human health and safety, and

the environment. While pursuing one objective with a positive impact, this may at the same time increase the negative impact of another objective.

For example, a catering company operating worldwide may want to reduce CO_2 emissions due to transport of food and consequently decide to source food locally. The trade-off may be difficult as local food production may involve farmers whose children participate in the local food production. It has to be reminded that companies would not face these dilemmas if local governments applied minimum environmental, social and human rights standards and controlled the application of these standards.

3.4 FURTHER PROMOTION OF RESPONSIBLE BUSINESS CONDUCT AND CSR UNDER THE TRADE AND SUSTAINABLE DEVELOPMENT CHAPTERS OF EU BILATERAL FTAS

As the EU templates for the **Trade and Sustainable Development (TSD) chapters** under bilateral Free Trade Agreements (FTAs) already include provisions on the promotion of responsible business conduct (RBC) and corporate social responsibility (CSR) and the adoption of supportive legal framework by the parties, this basis **should be upgraded to incentivise our trading partners to improve RBC and CSR practices** by their domestic companies and foreign-invested companies. In addition to existing commitments, the TSD chapters could include an **obligation to report on actions taken** in this respect.

Furthermore, AFEP supports the use of **sanctions in the event of non-compliance with FTAs**, in particular with TSD chapters. This is the only way to ensure full-fledged enforcement of RBC and CSR over the supply chain, without undermining EU companies' competitiveness and EU jobs. When assessing non-compliance with TSD chapters commitments, the dispute settlement mechanism should, of course, determine whether they led to a competitiveness edge as a prerequisite to imposing sanctions.

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About AFEP

Since 1982, AFEP brings together large companies operating in France. The Association, based in Paris and Brussels, aims to foster a business-friendly environment and to present the company members' vision to French public authorities, European institutions and international organisations. Restoring business competitiveness to achieve growth and sustainable employment in Europe and tackle the challenges of globalisation is AFEP's core priority. AFEP has around 113 members. More than 8 million people are employed by AFEP companies and their annual combined turnover amounts to €2,600 billion.

AFEP is involved in drafting cross-sectoral legislation, at French and European level, in the following areas: economy, taxation, company law and corporate governance, corporate finance and financial markets, competition, intellectual property and consumer affairs, labour law and social protection, environment and energy, corporate social responsibility and trade.

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