POSITION PAPER

DECEMBER 2020

EUROPEAN POLICY OPTIONS FOR UNDERTAKINGS' DUE DILIGENCE THROUGH THE SUPPLY CHAIN

Large French companies have been engaged for many years in putting responsible business conduct (RBC) at the heart of their strategies and operations. They present a **high 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 to engage in the circular economy.

Large French companies apply the **French Law on the Corporate Duty of Vigilance**, adopted in 2017, and have taken steps to ensure a **better control of risks linked to human rights and sustainability** along their supply chains. In this respect, they have launched or participate in numerous sectorial initiatives in addition of their own ones.

For example, they have developed **common codes of conduct setting out social and environmental industry standards** which they seek to conform with and require their suppliers to acknowledge and implement; they have designed **assessment tools** to measure gaps with these standards and they organise the **mutualisation of sustainability audits** to make the latter more efficient. They are also engaged in significant transparency efforts through the **publication of vigilance plans** and the **reporting of extra-financial KPIs**.

AFEP member companies would like to build on this unique background and hindsight to make an **experience-based contribution** to the Commission's preparatory work and the discussions taking place in the European Parliament in the field of companies' due diligence through the supply chain.

Key messages

AFEP is in favour of a European legislative framework on undertakings' due diligence and is eager to work together with the European Institutions to find a **pragmatic and fair approach** to tackle this highly complex and global challenge and calls for close cooperation between all stakeholders involved.

Regarding the debate on a mandatory due diligence law, AFEP would like to underline the following points which should be considered by a potential future European due diligence obligation:

1. The EU legislative framework should aim at creating a **fair level playing field**, in particular when defining the scope.
2. The **topics covered** by the EU legislative framework should be **clearly circumscribed**.
3. The **precise content** of due diligence requirements should be clearly defined to avoid legal uncertainty.
4. The **requirement to publish** due diligence strategy should be **proportionate and compatible with the preservation of commercial secrets.**
5. The **involvement of stakeholders** in the definition of the due diligence strategy should be **well balanced** as the latter remains a prerogative of the Board of Directors.
6. A due diligence legislative framework is not the appropriate place to introduce **corporate governance issues** which need a more holistic approach.
7. The **supervision** system put in place should be **efficient and avoid administrative burden.**
8. The core principles regarding **liability** should be preserved: **liability lies with the party who has caused damage**.
9. **Forum and jurisdiction shopping** should be avoided: there is no need to change Brussels I and Rome II Regulations.
10. Extra-judicial **remedies, proactive/voluntary solutions** and grievance mechanisms can play an effective role and should be prioritised.

French Association of Large Companies
www.afep.com

11 avenue Delcassé
75008 Paris

4-6 rue Belliard
1040 Brussels

1.

THE EU LEGISLATIVE FRAMEWORK SHOULD AIM AT CREATING A FAIR LEVEL PLAYING FIELD, IN PARTICULAR WHEN DEFINING THE SCOPE

Any obligation should apply both to undertakings and to contracting authorities

■ Responsible business conduct is expected from **all undertakings, "regardless of their ownership structure"** (OECD Due Diligence Guidance, p. 9), while taking into account the administrative burden. According to Principle 4 of the UN Guiding Principles on Business and Human Rights (UNGP), States "should take additional steps to protect against human rights abuses by business enterprises that are owned or controlled by the State, or that receive substantial support and services from State agencies". The concept of "undertaking" referred to in the European directive on due diligence should thus encompass, just as in competition law, **"every entity engaged in an economic activity, regardless of the legal status of the entity and the way in which it is financed"** (ECJ, 23/04/1991, Höfner and Elser, Case C-41/90, § 21), that is every entity that engages in "*any activity consisting in offering goods and services on a given market*" (ECJ, 12/09/2000, Pavlov, Cases C-180/98 to C-184/98, § 75).

■ **Public authorities should stand as an example in fostering sustainable value chains.** In this vein, UNGPs Principle 6 provides that: "*States conduct a variety of commercial transactions with business enterprises, not least through their procurement activities. This provides States – individually and collectively – with unique opportunities to promote awareness of and respect for human rights by those enterprises, including through the terms of contracts (...)*". This is echoed by the Council of Europe Recommendation CM/Rec(2016)3 according to which : "*Member States should apply additional measures to require business enterprises to respect human rights, including, where appropriate, by carrying out human rights due diligence, that may be integrated into existing due diligence procedures, **when member States:–conduct commercial transactions with business enterprises, including through the conclusion of public procurement contracts***" (Appendix, paragraph 22). Yet, suppliers of European States have been involved in several human rights violations or breaches of labour law (C. Methven O'Brien, Business and human rights - A handbook for legal practitioners, Council of Europe Ed., 2019). The adoption of the European directive on due diligence offers a unique opportunity to tackle this issue, by **applying due diligence requirements also to contracting authorities within the meaning of the Directive 2014/24/EU on public procurement.**

Any obligation should also cover non-EU undertakings providing goods or services in the EU

■ Mandatory due diligence imposed only on EU undertakings **would undermine the positive effect of the legislation and lead to a competitive disadvantage**. Their competitors from outside the EU would continue to enter the EU market with products and services possibly not respecting social and environmental minimum standards. Therefore, any requirement that may be introduced at EU level should apply to undertakings based in the EU or outside.

■ However, an EU legislation alone will have no effect on non-EU undertakings competing with EU undertakings outside the EU. For this reason, **the EU should adopt a holistic approach, including trade policy tools**. In particular, EU templates for the Trade and Sustainable Development (TSD) chapters under bilateral Free Trade Agreements should be upgraded and enforced to make sure that EU trading partners improve responsible business conduct and CSR practices by their domestic companies and foreign-invested companies. Dispute settlement mechanisms and sanctions in the event of non-compliance with TSD chapters of FTAs should be introduced, subject to competitiveness edge test.

2.

THE TOPICS COVERED BY THE EU LEGISLATIVE FRAMEWORK SHOULD BE CLEARLY CIRCUMSCRIBED

To be effective, mandatory due diligence should focus on very specific and clearly defined human rights and environmental risks

■ **Human rights risks, including social issues**, should be defined by reference to the Charter of Fundamental Rights of the European Union (CFR), to UNGP, i.e. rights expressed in the International Bill of Human Rights coupled with the principles concerning fundamental rights in the eight ILO core conventions as set out in the Declaration on Fundamental Principles and Rights at Work. Such definitions shall be easily readable and unequivocal.

■ **Environmental local risks** are those caused by activities directly on their surrounding environment. They are not caused by other operators in other geographic settlement. Those risks should cover air and water pollution, deforestation, and the sustainable use of natural resources and direct impacts on biodiversity.

■ **Climate change is a global environmental risk** as it is resulting from a multitude of actors, **wherever they are located. It is also a cumulative phenomenon over time** as CO_2 emissions remain for about one century before being disintegrated. In this view, **it is not possible to attribute responsibility for climate change to one single operator**. At global level, the UN Paris Agreement Climate Protocol sets up responsibility for reducing greenhouse gases (GHG) emissions to States which are parties to the Agreement. Given this specificity of global effect, **it is not possible to define due diligence on climate change for a specific company.**

■ **The issue of climate change should therefore be addressed in a different, appropriate legislative framework.** The revision of the Non-financial Reporting Directive is a good opportunity to discuss and elaborate how strategic information on climate change should be disclosed and integrated in the non-financial statement. Companies are committed to make their **best efforts to reduce GHG emissions** to limit collectively, together with all other GHG emitters, the temperature increase at the level mentioned in the Paris Agreement.

Companies could publicly explain, in their non-financial statement, their **strategy to mitigate GHG emissions** by disclosing:

• their **voluntary GHG targets/trajectories settings**,
• their implementation **provisions/dedicated resources**
• their **methodologies** for regular steering of their GHG efforts taking into account uncertainties.

The EU should consider a separate legislative initiative concerning the fight against Bribery

■ **National legislations, within or outside the EU** (e.g. the US FCPA, the UK Bribery Act, the French Sapin 2 Law), **have adopted ambitious and extra-territorial provisions to fight corruption**. As corruption requires zero tolerance, the undertaking must promote and disseminate a culture of anti-corruption compliance by establishing the prevention and detection of corruption at a prioritization level. A separate framework is justified because of the specificities of the issue which require to put in place dedicated means. It may be noted that France and the UK have adopted separate legislations governing due diligence in relation to supply chains on the one hand and the fight against corruption on the other hand.

■ The EU needs a **harmonised framework with an extraterritorial scope** (like GDPR) to avoid fragmentation, comparable to the rules adopted by some of our major trade partners. This would also be an important political signal from the EU to other trade partners that active or passive corruption will not be tolerated.

3

THE PRECISE CONTENT OF DUE DILIGENCE REQUIREMENTS SHOULD BE CLEARLY DEFINED TO AVOID LEGAL UNCERTAINTY

It should be made clear what precisely is expected from EU organisations so that they are able to comply with the rules and avoid sanctions

■ Mandatory due diligence should focus **on the first tier of the supply chains** (direct subcontractors or providers) where co-contractors are effectively able to exercise leverage through the contractual relationship. Regarding any further obligation down the supply chain, clarity should be given as to how companies should take measures to exercise leverage as it is practically impossible for undertakings to control every single part of supply chains comprising multiple tiers with hundreds or thousands of locations and players*.

■ With a view to make the legislation efficient, including through effective allocation of companies' resources, it must focus on the **most severe risks**, as per a risk-based approach, taking into account the fact that it is **impossible to mitigate every single risk on the supply chains**. Due diligence is an ongoing process which has to be improved over time focusing first on the most salient risks before analysing less important risks.

■ It must focus on the supply chain **upstream** (direct subcontractors or providers) **and not midstream** (e.g. JV partners) or **downstream** (e.g. distributors, clients and consumers). The inclusion of the professional customers would generate an inefficient workload. Indeed, the supplier would try to apply its own due diligence regarding the customer whereas the customer would apply its own due diligence regarding the supplier. It seems neither appropriate nor necessary to generate a stack of rules and overlapping due diligence obligations.

■ **Due diligence in relation to the use of products would be difficult to achieve** because it would require companies to dictate the consumption habits and practices of other companies and individuals. Such scrutiny would also prove invasive on a privacy level as regards consumers and could create competitiveness issues amongst economic actors. It may be appropriate to introduce **sectorial specific prescriptive legislation** in relation to certain types of products where significant risks exist.

■ It must be based on an **obligation of means rather than results** because it is impossible to guarantee "zero risk" on the supply chains. Even the best sus-tainability audit carried out at a given time does not ensure that a moment later the level of compliance with contractual clauses will not significantly de-crease for reasons that cannot always be anticipated or monitored.

■ **Specific liability standards** shall apply when the specificities of the relevant market limit the enterprises' negotiation and influence power (such as rare commodities, de facto monopolies (IP related or not) or dealings with companies that have a significant market power or are backed by a government).

** For example, a mid-sized company of 500 employees has 1000 first tier suppliers. Each of the 1000 suppliers has 500 further suppliers. It is impossible for a company of 500 employees to constantly assess and control more than 500 000 companies (only on second tier). The same applies for large companies that have up to 100 000 first tier suppliers.*

4

THE PUBLICATION OF THE DUE DILIGENCE STRATEGY SHOULD BE PROPORTIONATE AND COMPATIBLE WITH THE PRESERVATION OF COMMERCIAL SECRETS

EU undertakings should be required to publish categories of the most severe risks, while not disclosing details of all their suppliers and business relations along supply chains

- This information is extremely **sensitive** and would allow competitors to gain insights that could seriously harm EU undertakings obliged to such transparency. Indeed, undertakings develop, sometimes over decades, business relationships with their suppliers who bring them specific and precious know-how and expertise which ultimately contribute to a product's or service's added value. By disclosing their contact details, competitors will be able to benefit from a highly strategic commercial information which may undermine **professional secrecy rules.**

- In the case of large multinational companies, the list of all suppliers and business relations would fill thousands of pages without any added value for users. It would **make much more sense to require the publication of severe risks related to sustainability** along supply chains which would allow interested parties and stakeholders to understand the due diligence strategy of the company.

- Such a publication also **interferes with EU competition law** that stipulates in Communication 2011/C 11/01 that competitors are not allowed to share strategic data as this can be an indication of a possible anticompetitive agreement.

Precise requirements should be defined regarding the reporting of the due diligence strategy

- It would be impossible for large multinational companies to report all their due diligence processes all over the world concerning their hundreds of thousands of suppliers or sub-contractors, country by country, project by project or activity by activity. A requirement to publish thousands of pages would lead to an **"information overkill"**, making it impossible for the reader to grasp the essence of a company's due diligence strategy. The reporting requirements should therefore be focused on the **typology of salient risks** identified across undertakings' activities, which would allow interested parties and stakeholders to understand the due diligence strategy of the undertaking.

A group of undertakings should be allowed to publish one due diligence strategy for all its subsidiaries

- The controlled subsidiaries should be deemed to satisfy the due diligence obligation if the undertaking which controls them establishes and implements a due diligence strategy for the undertaking's operations, as well as the operations of all the subsidiaries or undertakings that it controls.

5

THE VIEWS OF STAKEHOLDERS WILL BE CONSIDERED FOR THE DEFINITION OF THE DUE DILIGENCE STRATEGY BUT THE LATTER REMAINS A PREROGATIVE OF THE DECISION-MAKING BODY

■ **It is up to the Board of Directors** (or other ultimate corporate decision-making body) – and ultimately its responsibility – **to define the company's strategy**, regardless of whether it concerns social, economic, financial or sustainable matters. In France, employees representing a category of stakeholders are already included in Board decisions through the designation of Directors representing employees (Article L.225-27-1 of the commercial code). The latter participate in Board meetings with the same rights and duties as any other non-executive director.

■ **Stakeholders' consultation is good practice and should be encouraged**. However, each company must find the best and most appropriate way of conducting such stakeholder consultations (centralised vs. decentralised; annual vs. on-going; problem-based workshops vs. strategic consultative committees ...). Depending on the sector, the organisation, the size, and the challenges the company is facing, it will adapt its consultation methodology. In addition, it is practically impossible to consult or to give access to all stakeholders when defining the due diligence strategy.

6

CORPORATE GOVERNANCE ISSUES NEED A MORE HOLISTIC APPROACH, SEPARATE FROM DUE DILIGENCE LEGISLATION

■ To allow a more holistic approach, **subjects relating to the Board's/ corporate decision-making body's responsibility or the qualification of Board members should be dealt with through other initiatives**. ESG issues are an increasingly important governance issue, but they are only one part of the responsibility of the Board of directors. The French national framework already provides rules on directors' duties which **must consider social and environmental aspects of the company's activities**. The same approach has been developed in national Corporate Governance Codes. Therefore, before taking any legislative action, the overall governance framework should be assessed.

■ Regarding the qualification of Board members, this subject is key, but is not limited to non-financial issues. Indeed, the right skills of board members depend on many factors (size, line of business, countries in which the undertaking operates...). We would suggest **leaving this matter to corporate governance codes as a flexible approach is needed**.

■ The issue of directors' remuneration is already included in the shareholders' rights directive which has only recently been implemented by Member States. Article 9a states that *"The remuneration policy shall contribute to the company's business strategy and **long-term interests and sustainability** and shall explain how it does so". "Where a company awards variable remuneration, the remuneration policy shall set clear, comprehensive and varied criteria for the award of the variable remuneration. It shall indicate the financial and non-financial performance criteria, including where appropriate, **criteria relating to corporate social responsibility** (...)"*. In our view, key principles are already set. We do not need an additional layer of legislation. In many

Members States, corporate governance codes have supplemented legal provisions. It is the case of the AFEP-MEDEF code which recommends that compensation *"must be competitive, adapted to the company's strategy and context and must aim, in particular, to improve its performance and competitiveness over the medium and long term, notably* ***by incorporating one or more criteria related to social and environmental responsibility****".*

7

THE SUPERVISION SYSTEM PUT IN PLACE SHOULD BE EFFICIENT AND AVOID ADMINISTRATIVE BURDEN

National competent authorities should have a role to play as "help desks" rather than quasi-courts

■ From a practical point of view, as the legislative framework is likely to cover a large scale of undertakings, it is difficult to see how a national authority, even the most staffed one, may supervise, in an effective way, all companies subject to the due diligence requirements. The role of the competent authorities could therefore be designed to **act as "help desks"** for undertakings to analyse risks and implement their due diligence strategy instead of quasi-courts settling disputes between undertakings and plaintiffs and imposing sanctions. Such powers should be reserved for the Courts. It should also be stressed that **OECD National Contact Points** already have an important function as extra-judicial mechanisms for dispute resolution and the **effectiveness of theses mechanisms should be assessed before envisaging the creation of new authorities** or the attribution of new functions to existing authorities.

■ In any case, should a supervisory authority be designated, there should **be one single authority responsible for the supervision of the implementation in case of a group of companies**, to avoid multiple supervisions.

■ The EU should also initiate a reflection on the **control and market surveillance processes over products entering the single market**, to ensure a level playing field between EU and non-EU companies.

As an alternative, the possibility to designate independent third parties should be envisaged

■ AFEP proposes the optional designation of **independent third parties explicitly accredited for verifying due diligence information published by undertakings.** This would be a coherent addition to the verification of non-financial statements, already required in some EU Member States and envisaged by the Commission in the context of the revision of the Non-financial Reporting Directive (NFRD). If this proposal is retained, a rigorous process of accreditation of these independent third parties by one of the signatories of the European Accreditation Multilateral Agreement (EA MLA), should be put in place in order to guarantee the quality, legitimacy and credibility of such verifications.

8

THE CORE PRINCIPLES REGARDING LIABILITY SHOULD BE PRESERVED: LIABILITY LIES WITH THE ONE WHO HAS CAUSED THE DAMAGE

■ The concept of due diligence is highly complex and **requires the collaboration of many stakeholders, within but also outside undertakings**: suppliers, sub-contractors, clients, investors, States, local authorities and communities, NGOs, consumers... **Undertakings alone cannot be expected to solve all the problems arising from failing or weakly governed States** in which protective laws, guaranteeing human rights or the protection of the environment, are either inexistent or not applied.

■ AFEP believes that it is **legitimate that EU companies could be held liable for damages which they have directly caused or intentionally contributed to**. However, where companies demonstrate that they have put in place appropriate due diligence measures, they should not incur any liability for damages occurring in their supply chain. In any case, multiple civil liability suits should be avoided within a group of companies as the parent company establishes the due diligence strategy for its own operations and those of its subsidiaries.

■ **It would be unfair to hold European undertakings liable when it is impossible to fully control every single part of the chain** and many other actors in third countries are involved. Only joint efforts, for example at a sectoral or multi-industry level, together with trade unions, international organisations and civil society can exercise enough leverage for change to happen. Such efforts shall be supplemented by concurring EU institution led efforts such as measures incorporated through commercial agreements, norms and/or certifications. Continuous improvement of the practices shall be encouraged rather than an all punitive framework so as to help organizations to improve their process and take into account the efforts implemented.

■ **UNGP and OECD Guidelines are perfectly clear that due diligence does not shift responsibilities**, neither from governments to companies, nor from suppliers or subcontractors to the companies placing the order. Each State or company has its own responsibility for the direct actions it takes and the adverse impacts they may have. The companies' due diligence obligations should neither remove the liability of each local actor for its acts, nor shift the burden of liability onto EU companies.

9

FORUM AND JURISDICTION SHOPPING SHOULD BE AVOIDED: THERE IS NO NEED TO CHANGE BRUSSELS I AND ROME II REGULATIONS

■ The courts of the **EU Member States cannot become the reference courts for dealing with violations of human rights all over the world**, when the means allocated to them do not always allow them to deal with internal disputes in a timely manner.

■ Circumventing the competence of local authorities or the application of local laws could be interpreted as a violation of the right of people to self-determination and could impair the *non bis in idem* principle. In any event, it would raise **serious concerns in terms of legal certainty and risk assessment predictability**.

10

EXTRA-JUDICIAL REMEDIES, PROACTIVE/VOLUNTARY SOLUTIONS AND GRIEVANCE MECHANISMS CAN PLAY AN EFFECTIVE ROLE AND SHOULD BE PRIORITISED

Grievance mechanisms at company level contribute to effective, on-the-ground-access to remedy and should be encouraged according to UNGP

■ Operational grievance mechanisms at company level are an important and efficient means to detect negative impacts at an early stage. They should be established according to **the effectiveness criteria set out in Principle 31 of UNGP and should provide for anonymous complaints**.

■ Should they be envisaged, **reporting obligations in relation to grievance mechanisms could cover information on overall categories of concerns raised**, e.g. discrimination, safety issues etc. On the contrary, disclosure of detailed information related to individual complaints collected via the grievance mechanism would not be appropriate because this would violate the principle of safety for victims. Indeed, victims need to be assured of the confidentiality of their complaints to protect them.

■ Companies should **not be obliged to publish individual complaints collected via the grievance mechanism** because this would violate the principle of safety for victims and could impair the presumption of innocence principle. Indeed, victims need to be assured of the **confidentiality of their complaints** to protect them. If a reporting obligation were to be envisaged, it should be limited to the overall categories of concerns raised, e.g. discrimination, safety issues etc.

The role of OECD National Contact Points (NCP) should be promoted as they offer a unique State-based non-judicial mechanism through which the non-respect of OECD Guidelines can be effectively raised

■ Almost 50 NCPs currently exist for each government adhering to the OECD Guiding Principles. **The NCPs offer a non-judicial grievance mechanism** which help to resolve issues that can arise if the OECD Guidelines are not observed. **NCPs are often more efficient than lengthy judicial procedures**. They contribute to improving access to remedy for victims of business-related rights violations, especially in cross-border transactions where judicial systems may fail.

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 115 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.

Contact :
Odile de Brosses, Legal Affairs Director, o.de.brosses@afep.com
Elisabeth Gambert, CSR & International Affairs Director, e.gambert@afep.com
Justine Richard-Morin, European Affairs Deputy Director, j.richard-morin@afep.com