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ESG Update: EU Business and Human Rights Developments

EU Parliament Proposes Mandatory Due Diligence and Corporate Accountability Legislation

EU Also Establishes Global Human Rights Sanctions Regime

European Countries and Courts Take Other Steps on Corporate ESG Accountability

SUMMARY

The regulation of businesses with the aim of protecting human rights and achieving other ESG-related goals is a rapidly developing area of law globally. The EU is currently in the process of developing ambitious and far-reaching mandatory corporate due diligence and accountability legislation, which would require companies incorporated or operating in the EU to assess, report on and address risks of human rights, environmental and good governance-related violations in their operations and supply chains. Germany is currently developing a similar proposal applicable to German entities, as are other European countries.

Several European courts have also taken recent steps to expand corporate accountability for human rights violations of foreign subsidiaries. The EU has also recently established a global human rights sanctions regime which enables it to penalize individuals and entities accused of human rights violations, or those associated with such persons or entities.

Businesses with operations in Europe should monitor developments in this area closely and take steps as necessary to establish and/or amend internal policies and practices to comply with any applicable new regulatory requirements.

I. BACKGROUND

The UN Human Rights Council's 2011 endorsement of the UN Guiding Principles on Business and Human Rights (UNGPs) established an international framework setting out foundational and operational

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principles of a corporate responsibility to respect human rights, including obligations of companies to conduct human rights due diligence, remedy any actual or potential harms and provide grievance mechanisms for affected stakeholders. The UNGPs have subsequently received widespread support, and the OECD¹ and the ILO² have also adopted similar frameworks and standards.³

However, the voluntary nature of these frameworks and lack of legal enforcement mechanisms is thought to undermine their effectiveness. In contrast, some specific sectors have been targeted for mandatory ESG due diligence and compliance measures, including conflict minerals,⁴ natural resources,⁵ timber⁶ and the garment industries.⁷ The recent increase in focus on ESG factors by investors, customers, civil society and regulators has heightened scrutiny on corporate accountability globally.

A number of EU bodies as well as national governments have recently taken steps to develop and implement mandatory frameworks across all sectors of the economy in order to address perceived deficits in corporate responsibility and enforcement mechanisms in relation to human rights and environmental compliance.

¹ OECD Due Diligence Guidance for Responsible Business Conduct provides practical support to enterprises on the implementation of the OECD Guidelines for Multinational Enterprises by providing explanations of its due diligence recommendations and associated provisions.

² ILO MNE Declaration of Principles provides guidance to multi-national and national enterprises on social policy and inclusive, responsible and sustainable workplace practices.

³ See also the United Nations Global Compact, a framework which encourages businesses to adopt and to report on sustainable and socially responsible policies.

⁴ See, e.g., Regulation (EU) 2017/821 of the European Parliament and of the Council of 17 May 2017 laying down supply chain due diligence obligations for EU importers of tin, tantalum and tungsten, their ores, and gold originating from conflict-affected and high-risk areas. See also Section 1502 of the US Dodd-Frank Act of 2010, seeking to require disclosure of whether any conflict minerals that are necessary to the functionality or production of products originated in the Democratic Republic of the Congo or an adjoining country.

⁵ See our recent client memorandum: [“SEC Adopts Rules Implementing “Resource Payments” Disclosure Requirements of the Dodd-Frank Act”](#)

⁶ See, e.g., Regulation (EU) No 995/2010 of the European Parliament and of the Council of 20 October 2010 laying down the obligations of operators who sell timber and timber products in the EU and the EU Forest Law Enforcement, Governance and Trade Action Plan. See also the 2009 United States-Peru Trade Promotion Agreement’s Annex on Forest Sector Governance, under which the US Government has blocked imports of illegally harvested Peruvian timber.

⁷ For example, the European Commission has proposed to develop a comprehensive EU Strategy for Textiles as part of its 2021 Circular Economy Action Plan.

II. PROPOSED EU MANDATORY HUMAN RIGHTS, ENVIRONMENTAL AND GOOD GOVERNANCE DUE DILIGENCE AND CORPORATE ACCOUNTABILITY DIRECTIVE

A. BACKGROUND

Human rights due diligence (HRDD) requires a company to take measures to prevent adverse impacts on human rights from occurring in their value chains and to address such impacts when they occur.

According to a European Commission publication released in February 2020, only 37% of business respondents currently conduct environmental and human rights due diligence in their operations and supply chains.⁸ In April 2020, the Commission announced plans to make an EU legislative proposal in 2021 which would require mandatory HRDD across all sectors for a wide range of companies, potentially including multi-national companies based outside of the EU.⁹

Although the Commission has not yet tabled draft legislation, the European Parliament (EP) adopted a set of recommendations on March 10, 2021, including a draft directive for the Commission to consider.¹⁰

B. SCOPE OF ENTITIES COVERED

The EP resolution recommends that HRDD obligations should be broadly applicable to a wide range of companies, including:

- a) large undertakings governed by the law of an EU Member State or established in the territory of the EU, regardless of the sector in which they operate;
- b) all publicly-listed small and medium-sized undertakings, as well as high-risk small and medium-sized undertakings, in each case which are governed by the law of an EU Member State or established in the territory of the EU; and
- c) large undertakings and publicly-listed or high-risk small and medium-sized undertakings which are not governed by the law of a Member State or established in the territory of the EU, when they operate in the EU internal market selling goods or providing services.

The EP resolution recommends that the Commission identify and define high-risk sectors and high-risk small and medium-sized undertakings in order to establish the scope of the directive.

C. OBLIGATIONS

The EP's draft directive would require in-scope companies to:

- ***Establish due diligence processes*** to identify, assess, prevent, monitor, and remedy potential and/or actual adverse impacts on human rights, on the environment, and on good governance in its operations and business relationships. Businesses shall carry out in good faith effective, meaningful and informed discussions with relevant stakeholders, including

⁸ [Study on due diligence requirements through the supply chain](#), January 2020, European Commission, Directorate General for Justice and Consumers.

⁹ The announcement was made during an online event hosted by the EU Parliament's Responsible Business Conduct Working Group. The webinar can be found [here](#).

¹⁰ [European Parliament resolution](#) of March 10, 2021 with recommendations to the Commission on corporate due diligence and corporate accountability.

trade unions and workers' representatives, when establishing and implementing their due diligence strategy;

- **Carry out value chain due diligence** which is proportionate and commensurate to the likelihood and severity of their potential or actual adverse impacts and their specific circumstances, particularly their sector of activity, the size and length of their value chain, the size of the undertaking, its capacity, resources and leverage;
- **Ensure that their business partners put in place and carry out policies** with respect to human rights, environmental and good governance that are in line with the company's due diligence strategy, including, for instance, by means of contractual arrangements, codes of conduct and/or certified and independent audits, and regularly verify that subcontractors and suppliers comply with these obligations;
- **Ensure that their purchase policies do not cause or contribute to potential or actual adverse impacts** on human rights, the environment or good governance;
- **Publicly disclose their due diligence strategy**, which should be evaluated annually and revised as necessary;
- **Provide access to a grievance mechanism** aligned with the UNGPs allowing any stakeholder to voice reasonable concerns and provide for timely and effective responses. Companies may provide such a mechanism through collaboration with other businesses or organizations; and
- **Provide for and cooperate in a remediation process** where they have identified that they caused or contributed to an adverse impact on human rights. The remedy should be determined in consultation with affected stakeholders and may consist of: financial or non-financial compensation; reinstatement; public apologies; restitution; rehabilitation; or a contribution to an investigation.

D. REMEDIES, LIABILITY AND PENALTIES

The EP's draft directive would require Member States to ensure that violators can, in accordance with national law, be held liable for any breaches, and provide remediation for any harm arising out of 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. There are exceptions to these requirements if a company can prove that it took all due care in line with the directive to avoid the harm in question, or that the harm would have occurred even if all due care had been taken.

Affected individuals may file a complaint before national competent authorities who will be responsible for carrying out investigations to ensure the obligations in the directive are complied with. National competent authorities may impose proportionate fines in cases of non-compliance or violation, calculated on the basis of an undertaking's turnover, and may also impose 'other appropriate administrative sanctions'. The quantum of administrative fines is expected to be comparable to fines currently provided for in competition and data protection law.

The Commission's draft legislation is currently expected to be tabled during Q2 of 2021. A directive, if enacted, will need to be implemented by each Member State.

III. PROPOSED GERMAN SUPPLY CHAIN LAW

In parallel with the EU's proposals, Germany is also developing a mandatory due diligence law after perceived shortcomings in existing voluntary measures (such as the German National Action Plan for

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Business and Human Rights 2016-2020).¹¹ On March 3, 2021, Germany's cabinet approved a proposed Human Rights Due Diligence Law.¹² It is scheduled to be considered by the German Parliament before the federal elections in September 2021.

The proposed law would apply to companies with a registered office or their principal place of business in Germany. It would apply to companies with more than 3,000 employees from 2023, then to companies with more than 1,000 employees from 2024.

The proposed obligations set out in the draft law derive from the principles of the UNGPs and the OECD's Guidelines for Multinational Enterprises, including the requirement for companies to (i) have procedures to identify risks and (ii) publish an annual report on actual and potential human rights violations. The law would also require companies to implement a complaints procedure for individuals to anonymously report human rights risks or violations. The specific business activity of the company is determinative of the necessary levels of risk analysis.

Penalties for non-compliance will include fines that could amount to up to 2% of average annual revenue for companies with €400m or more in annual revenue. Additionally, violations could result in exclusion from participation in public tenders for up to three years.

An affected individual would not be entitled to bring claims directly against a violator. Instead, they must submit an application to the competent authority so that the latter can then in turn take action, for example submitting information requests or impose penalties, against the company.

IV. EU GLOBAL HUMAN RIGHTS SANCTIONS REGIME

In December 2020, the Council of the EU adopted a regulation establishing a global human rights sanctions regime (the "Sanctions Regulation")¹³ and an accompanying decision.¹⁴ The Sanctions Regulation defines human rights by setting out a non-exhaustive list of human rights abuses which include crimes against humanity, cruel, inhuman or degrading treatment, and violations of freedom of opinion and expression, among others. The regime applies irrespective of where the violation of human rights occurred.

The Sanctions Regulation applies to any legal person, entity (including companies) or body which is incorporated or constituted under the law of a Member State; to any legal person, entity or body, in respect of any business done in whole or in part within the EU; and to any citizen of a Member State. It

¹¹ A [nationwide survey of the NAP](#) found that only 455 out of 2,250 corporates had answered the questionnaire and under half of the respondents were compliant with the due diligence framework.

¹² [Draft Mandatory Human Rights Due Diligence Law](#), German Federal Ministry of Labour and Social Affairs.

¹³ Council Regulation (EU) 2020/1998 of 7 December 2020 concerning restrictive measures against serious human rights violations and abuses.

¹⁴ Council Decision (CFSP) 2020/1999 of 7 December 2020 concerning restrictive measures against serious human rights violations and abuses.

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also targets companies and individuals who provide financial, technical or material support for or are otherwise involved in abuses.

The Council – acting unanimously – is responsible for designation of responsibility for human rights violations and companies/persons who provide assistance to such violators. Penalties for non-compliance with the Sanctions Regulation are set by each Member State.

Penalties that may be imposed include financial sanctions (e.g. freezing of funds that belong to or are controlled by a listed person, including subsidiary funds), travel bans and prohibitions on third parties doing business with a listed person.

The Council has recently added the first 19 entities and individuals to the sanctions list, in connection with alleged human rights violations and abuses in Russia, Libya, North Korea, South Sudan, Eritrea and China.¹⁵

V. OTHER RECENT DEVELOPMENTS

Other EU Member States are also considering mandatory HRDD legislation, including Austria, Denmark, Finland, Luxembourg, the Netherlands and Sweden. France has already adopted legislation (the 2017 Corporate Duty of Vigilance law) requiring companies to identify and prevent adverse human rights and environmental impacts from their own activities and those of companies they control and their subcontractors and suppliers. The law has yet to be significantly tested in the French courts, though several cases are currently underway.

In other jurisdictions, courts have recognized an expanded scope of potential corporate accountability under existing law. For example:

- In February 2020, the Supreme Court of Canada declined to dismiss a claim brought by Eritrean miners for breach of customary international human rights law by a Canadian corporation.¹⁶
- In January of this year, the Hague Court of Appeals ruled that parent companies may have a duty of care to those affected by the environmental impact of their overseas subsidiaries, depending on the extent of the parent company's de facto control over the subsidiary.¹⁷
- In February of this year, the UK Supreme Court held that companies may be liable in tort for the operations of their subsidiaries abroad where liability can be attributed to the parent according to "business and functional lines", rather than a strict corporate separateness analysis.¹⁸

¹⁵ See <https://www.consilium.europa.eu/en/press/press-releases/2021/03/22/eu-imposes-further-sanctions-over-serious-violations-of-human-rights-around-the-world/>.

¹⁶ *Nevsun Resources Ltd. v. Araya*, 2020 SCC 5 (CanLII), <https://canlii.ca/t/j5k5j>.

¹⁷ *Ogoru and others v Shell Petroleum NV and others* (ECLI:NL:GHDHA:2021:133).

¹⁸ *Okpabi v Royal Dutch Shell plc* [2021] UKSC 3.

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In addition, a case brought against two US corporations under the US Alien Tort Statute by former child slaves in Ivory Coast is currently being considered in the US Supreme Court.¹⁹ The outcome may have significant implications for the ability to sue US corporations in US courts in respect of foreign human rights violations.

VI. IMPLICATIONS

The intersection of law, business, human rights and the broader set of ESG factors continues to grow, and businesses should closely monitor ongoing legal developments in this area.

A wide-ranging EU mandatory ESG due diligence regime is likely to increase compliance burdens and potential liability of companies incorporated in, or operating in, the EU, but there are many details that need to be worked out by the European Commission and then, if enacted, by each Member State.

In any event, we anticipate businesses globally will face heightened pressure from other stakeholders such as customers, shareholders, lenders, employees, civil society, commercial counterparties and competitors to voluntarily increase their compliance and reporting efforts with respect to human rights and other ESG factors, as we have seen recently with respect to climate change and diversity.²⁰ We also expect an increased focus on human rights compliance in M&A and financing transactions going forward.

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¹⁹ *Nestlé USA, Inc. v. Doe I.*

²⁰ See our recent client memoranda: "[The Rise of Standardized ESG Disclosure Frameworks in the United States](#)"; "[SEC Focuses on Potential Updates to U.S. Climate Change Disclosure Requirements](#)" and "[Nasdaq Proposes Board Diversity Requirements.](#)"

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