

## The EU competence and duty to regulate corporate responsibility to respect Human Rights through mandatory Human Rights Due Diligence

- The protection of human rights from corporate abuse is one of today's most complex and pivotal challenges. Complicated corporate structures and relationships make it difficult, often even impossible, to attribute responsibility to parent and sub-contracting companies for human rights violations, and ensure effective accountability and redress for victims.
- The EU has the competence and the duty to address these challenges. It can and should adopt mandatory Human Rights Due Diligence legislation in order to substantially reduce corporate human rights violations, improve access to justice, and level the playing field for responsible companies.

### The concept of Human Rights Due Diligence

Human Rights Due Diligence (HRDD) is an **ongoing risk management** process that a company needs to have in place in order to identify, prevent, mitigate and account for how it addresses its adverse human rights impacts throughout its value chain. HRDD is one of the core elements of the **United Nations Guiding Principles on Business and Human Rights** (UNGPs).<sup>i</sup>

It is a crucial concept both in relation to the corporate responsibility to respect human rights (Pillar II) and to the State duty to protect them (Pillar I). Companies are required to respect human rights wherever they operate and to carry out HRDD to identify, prevent, mitigate and account for their human rights impacts.<sup>ii</sup> States, meanwhile, should “**enforce laws** that are aimed at requiring businesses enterprises to respect human rights”.<sup>iii</sup>

### Mandatory Human Rights Due Diligence Legislation

HRDD legislation is widely acknowledged to be the essential tool to compel and incentivize enterprises to respect and protect human rights, as recently affirmed by the **UN Committee on Economic, Social and Cultural Rights**.<sup>iv</sup> There are multiple ways in which human rights due diligence can be embedded into law.

Most importantly, it provides a basis for translating the corporate responsibility to respect human rights into a **legal obligation, under civil/tort law**, to adhere to a standard of reasonable care while performing any acts that could foreseeably harm others. Such legislation would extend the scope of this **duty of care** to a company's subsidiaries and business partners.

While this represents a powerful prevention mechanism, it also has incisive implications for access to justice. Affected people could bring a civil/tort action against the company, whereas the company could effectively discharge its liability by demonstrating it carried out human rights due diligence.

### The EU competence on Human Rights Due Diligence

#### The EU duty to protect human rights

The protection of human rights is one of the EU's overarching objectives and has acquired growing importance over the years. According to Article 2 of the **Treaty on the European Union** (TEU), “the Union is founded on the values of respect for human dignity, freedom, democracy, equality, the rule of law and respect for human rights.”

The treaties make abundantly clear that **the EU has a duty** to promote respect for human rights, within its powers and competences, when it adopts and implements EU legislation as well as in its relations to the wider world (Articles 2, 3.5 and 21 of the Treaty of the European Union, TEU).

## Acting on the basis of Article 50 and 114 TFEU

As pointed out by the European Commission in its Staff working document on implementing the UNGPs, in the EU context, **Member States and EU institutions share the duties embedded in the UNGPs** on the basis of their respective competences.<sup>v</sup> The regulation of companies' duty of care in the sense described above touches on matters of company law, hence it falls within EU shared competences.

In this respect, **Article 50(2)g** of the Treaty on the Functioning of the European Union (TFEU) gives the EU the competence to harmonise national company laws in order to attain freedom of establishment of companies. The EU shall carry out this duty by means of directives (Article 50(1)). In conjunction to Article 50, Article 114 TFEU allows for the EU to approximate legislation in order to ensure the establishment and proper functioning of the internal market.

Over the years, the EU and the Member States have interpreted these two articles so as to give the EU broad competence to harmonize legal and economic conditions for doing business across the EU and alleviate obstacles to a level playing field, while contributing to the achievement of other key EU objectives.

On the basis of Article 50, the EU has adopted **several directives harmonising company law**, for example Directive 2007/36/EC on the exercise of certain rights of shareholders in listed companies ('Shareholder Rights Directive')<sup>vi</sup>. The 2017 amendment of the Directive was intended to address the shortcomings in the corporate governance of publicly listed companies that were exposed by the financial crisis<sup>vii</sup>. The EU Accounting Directive (which contains a detailed legal definition of parent company for the purpose of consolidated accounts and reports<sup>viii</sup>) and particularly the Non-financial Reporting Directive<sup>ix</sup> (NFR Directive), which amended the former in 2014, represents another example.

### The Example of the Non-Financial Reporting Directive

The NFR Directive demonstrates the power, the competence, and the duty of the EU to enforce the principles enshrined in the UNGPs. According to Principle 3, States shall require companies "to communicate how they address human rights impact."<sup>1</sup> The NFR Directive accordingly requires large companies to disclose relevant information in relation to respect of human rights, as well as to protection of the environment, social and employee matters, and fight against corruption.

Based on Article 50(1) TFEU, the Preamble of the Directive stresses that "coordination of national provisions [...] is of importance for the interests of undertakings, shareholders and others stakeholders alike. Coordination is necessary because most of those undertakings operate in more than one Member State"<sup>1</sup>. Moreover, the European Commission justified the adoption of the Directive on the grounds that a "varied [reporting] pattern has led to a fragmentation of the legislative framework across the EU. That is why [the Directive] aims at **ensuring a level playing field**, at **limiting costs** for enterprises operating in more than one Member State, and ensuring easier and more **widespread investors' access to key, useful information**."<sup>1</sup>

## The Need for harmonization in HRDD legislation

### a. National laws and initiatives

The UNGPs were unanimously endorsed by the UN Human Rights Council in 2011. In the following years, many institutional and civil society-driven initiatives have brought the need to embed human rights due diligence into law to the heart of the public debate.

- **France** was the first country to adopt legislation that transposed HRDD into civil law. The "Devoir de Vigilance" Law passed in February 2017 imposes a duty of care on large parent companies for the activities carried out by subsidiaries, subcontractors and suppliers. It also establishes civil liability for harms resulting from a company's failure to observe its duty of care, on the basis of general tort law principles.

Without fully introducing human rights due diligence obligations for companies into civil law, other Member States have undertaken legislative processes which develop some HRDD elements:

- The **United Kingdom** has so far addressed the matter with issue-specific public disclosure legislation. The Modern Slavery Act adopted in 2015 includes a transparency provision requiring companies to disclose the steps undertaken (including due diligence measures) to ensure that slavery or human trafficking is not taking place in their supply chains.
- **The Netherlands** has been discussing a similar type of legislation to address child labour (Child Labour Due Diligence Law). The bill, currently awaiting Senate approval, requires companies to submit a statement to authorities declaring that they have carried out due diligence to ascertain whether child labour is present in their supply chains. The bill goes further than the UK law, setting out the expectation that companies draw up an action plan to eradicate child labour, when they have reason to presume it is taking place. The bill provides for third party complaints and ongoing non-compliance can result in a prison sentence for company directors.
- **Germany's** National Action Plan on Business and Human Rights (NAP) includes a Government commitment to consider legislative measures if fewer than half of major German companies adopt HRDD processes by 2020.<sup>x</sup> Other EU Member States, for instance the Netherlands, Sweden and Italy mentioned the issue of corporate human rights responsibility in civil law in their NAPs.
- **Switzerland** (while not a Member State, it is part of the EU single market via bilateral agreements) will hold a referendum on the “Responsible Business Initiative” on changing the Constitution to introduce a duty of care for companies registered or based in the country. This duty of care would include HRDD obligations and provide for civil liability based in tort law rules.

#### **b. Harmonisation as a preventive measure: ECJ case law**

A growing number of rules and standards across Europe impose a variety of due diligence duties and reporting requirements on companies, and establish different forms of administrative and civil liability. In Member States yet to introduce such standards, governments may seek to maintain the status quo, in an effort to present their jurisdiction as a low-regulation environment for business. This risks enabling irresponsible business practices and creating a two-tier system of corporate governance within the EU.

This is an obstacle to **the effective implementation of the UNGPs**, an objective which States and the EU have committed to achieve. Furthermore, there is a clear expectation from the European Commission and UN bodies that States will take decisive steps to put the Guiding Principles into practice.<sup>xi</sup>

The **European Court of Justice** has made abundantly clear that EU institutions can “act in order to forestall measures which would probably have been taken by the Member States”, in order to prevent disruption of the internal market; the EU is not required to wait until Member States’ divergent laws actually cause disruption.<sup>xii</sup>

Furthermore, the **principle of subsidiarity** decrees that the Union shall act whenever the objectives of the proposed action cannot be sufficiently achieved by Member States, but can be better achieved at the Union level.

This is the case with the need to ensure a high level of corporate responsibility to respect human rights. Moreover, taking no action would maintain the **state of play in which transnational and local companies that adhere to their responsibility to respect human rights outlined in the UNGPs have to compete with less responsible companies** that benefit from human rights violations in global value chains.

#### **c. Harmonisation of company laws to protect freedom of establishment and the internal market**

At this stage, an EU harmonisation initiative **based on the French “Devoir de Vigilance” Law** would ensure a **level playing field** for companies operating in different EU Member States, preventing obstacles to companies’ **freedom of establishment** and contributing to the proper functioning of the **internal market**.

Additionally, as per the NFR Directive, an EU HRDD law would **limit costs** for enterprises that operate in more than one Member State and would **enhance transparency** for consumers, shareholders, creditors and any other stakeholders in selecting who they want to buy from or work with, across the entire internal market. It would ultimately result in a **high level of human rights protection**, as required by EU treaties and international law.

### Political and institutional support

Time is ripe for an EU HRDD legislative initiative, as already acknowledged by several EU bodies and institutions.

The **Council** of the EU has repeatedly “encouraged the Commission to enhance the implementation of HRDD”<sup>xiii</sup>; the **European Parliament** considers that “new EU legislation is necessary to create a legally binding obligation of due diligence for EU companies outsourcing production to third countries”<sup>xiv</sup>; the **EU Agency on Fundamental Rights** stated that the recent French legislation “could serve as a model for the EU”.<sup>xv</sup> Moreover, in May 2016, eight national Parliaments launched a **green card initiative** calling on the EU Commission to initiate a legislative procedure to enhance corporate respect for human rights and the environment.<sup>xvi</sup>

### Conclusions

- Respect for human rights cannot be left to companies’ voluntary initiatives any longer;
- The EU can here lead the way. It has a treaty obligation to act, the competence to legislate, as well as the increasing support of Member States and EU institutions to do so.
- By utilising the power and competence to ensure the proper functioning of the internal market (art. 114 in combination with art. 50 TFEU) the European Union can and should make Human Rights Due Diligence part of European company law.

### Acknowledgements:

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## Endnotes:

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- <sup>i</sup> Guiding Principles on Business and Human Rights, Implementing the United Nations 'Protect, Respect and Remedy' Framework Article 17 (2011), UN Doc HR/PUB/11/04. Unanimously Adopted by the United Nations Human Rights Council, UN Doc. June 2011 A/HRC17/31 (hereinafter UNGPs).
- <sup>ii</sup> UNGPs 11, 15, 17.
- <sup>iii</sup> UNGPs 3.
- <sup>iv</sup> UN Committee on Economic, Social and Cultural Rights, General Comment No. 24 on State Obligations under International Covenant on Economic, Social and Cultural Rights in the context of Business Activities, 23 July 2017, E/C.12/GC/24, p.6.
- <sup>v</sup> European Commission, Commission Staff working document on implementing UNGPs – State of Play, Brussels 16 July 2015, SWD (2015) 144 final, p 6.
- <sup>vi</sup> Directive 2007/36/EC of the European Parliament and of the Council of 11 July 2007 on the exercise of certain rights of shareholders in listed companies.
- <sup>vii</sup> Directive (EU) 2017/828 of the European Parliament and of the Council of 17 May 2017 amending Directive 2007/36/EC as regards the encouragement of long-term shareholder engagement. See also Commission Proposal for a Directive of the European Parliament and of the Council amending Directive 2007/36/EC as regards the encouragement of long-term shareholder engagement and Directive 2013/34/EU as regards certain elements of the corporate governance statement.
- <sup>viii</sup> Seventh Council Directive 83/349/EEC of 13 June 1983 based on the Article 54(3)(g) of the Treaty on consolidated accounts replaced by Directive 2013/34/EU of the European Parliament and of the Council of 26 June 2013 on the annual financial statements, consolidated financial statements and related reports of certain types of undertakings. See Art. 22(1) of Directive 2013/34/EU for a definition of “parent undertaking”.
- <sup>ix</sup> Directive 2014/95/EU of the European Parliament and of the Council of 22 October 2014 amending Directive 2013/34/EU as regards disclosure of non-financial and diversity information by certain large undertakings and groups, (hereinafter NFR Directive).
- <sup>x</sup> See more on this in Business & Human Rights Resource Centre, “3entry points to implement the German National Action Plan”, available at: <https://business-humanrights.org/en/3-entry-points-to-implement-the-german-national-action-plan>.
- <sup>xi</sup> European Commission, Commission Staff working document on implementing UNGPs – State of Play, op. cit.; Human Rights Council, Human rights and transnational corporations and other business enterprises, Resolution A/HRC/RES/26/22, adopted on 27 June 2014;
- <sup>xii</sup> Case C-58/08 Vodafone v. Secretary of State for Business, Enterprise and Regulatory Reform, paras. 45-46, 2010 E.C.R. I-4999.
- <sup>xiii</sup> Council of the European Union, *The EU and Responsible Global Value Chain*, Brussels European Council, 12 May 2016, 8833/16, para. 9; Council of the European Union, *Council Conclusion on Business and Human Rights*, Brussels European Council, 20 June 2016, 10254/16, para. 6.
- <sup>xiv</sup> European Parliament resolution on the second anniversary of the Rana Plaza building collapse and progress of the Bangladesh Sustainability Compact (2015/2589(RSP)), 28 April 2015, para. 23.
- <sup>xv</sup> European Union Agency on Fundamental Rights, Opinion on improving access to remedy in the area of business and human rights at the EU level, Vienna, 10 April 2017, FRA Opinion – 1/2017, p. 17.
- <sup>xvi</sup> European Coalition for Corporate Justice, 'Members of 8 European Parliaments support duty of care legislation for EU corporations', 31 May 2016, available at <http://corporatejustice.org/news/132-members-of-8-europeanparliaments-support-duty-of-care-legislation-for-eu-corporation>.