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# **HUMAN RIGHTS DUE DILIGENCE:**

The European Union's Approach to Ensuring Respect for Human Rights in  
Business

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## **Abstract**

With increasing global attention on the relationship between business and human rights, the 2011 United Nations Guiding Principles on Business and Human Rights developed the notion of human rights due diligence as a means for companies to ensure that their activities do not violate peoples' rights. The approach is built on companies setting up and employing mechanisms to assess and mitigate the risks of human rights violations connected to their business activities. Mandatory due diligence focusing on human rights has been increasingly taken up by legislators, including at the level of the European Union. The present study examines three pieces of EU legislation enshrining different aspects of due diligence to show the potential of such mechanisms and examine what issues need to be taken into account when considering future laws mandating due diligence at EU level. The analysis highlights the need for greater clarity when legislating due diligence and calls for political leadership on part of the EU to ensure the effective use of due diligence requirements in pursuit of decreasing corporate human rights abuses worldwide.

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## Introduction

The area of business and human rights has been an expanding field of study in the past decades. The interest in the intersection between human rights and business operations has been driven mainly by social concern, with many governments and companies acknowledging that the issue is also an important part of efforts to ensure sustainable development. While there seems to be a general agreement about the importance of corporate respect for human rights, the means of achieving this goal has been the subject of heated debates. Companies often acknowledge that there is indeed a problem with respect for human rights, however, they are reluctant to agree that more regulation is needed. Governments often find themselves between two opposing sides: those calling for more stringent regulation on business and human rights – and those urging as much freedom as possible for companies.

It was in this context that the United Nations Guiding Principles on Business and Human Rights<sup>1</sup> (UNGPs) were developed and eventually endorsed by the UN Human Rights Council in 2011. The guidelines were created as the culmination of a highly inclusive consultation process that aimed to take all stakeholders' concerns and needs into account.<sup>2</sup> Given the adamant opposition by businesses against further regulation, the UNGPs are a non-binding set of principles that do not impose new legal obligations.<sup>3</sup> The document clarifies that states have the ultimate duty to protect human rights, while companies have a responsibility to respect such rights.

The UNGPs developed the notion of human rights due diligence as a way to operationalise the corporate responsibility to respect human rights. The use of due diligence was chosen as a way to maximise the positive impact on the protection of human rights, while at the same time minimising additional burdens on companies. It is described as a risk-based approach that includes companies assessing activities for possible human rights violations, taking action to mitigate the identified risks, tracking the effectiveness of the steps taken, and communicating information relating to human rights impacts and their mitigation to the public.<sup>4</sup> Some regulators are increasingly opting for making human rights due diligence mandatory as a way of responding to societal pressure to crack down on human rights violations by businesses. The approach is relatively novel, as most such laws have come into effect in the last decade, mainly in response to the UNGPs.

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1 United Nations, 'Guiding Principles on Business and Human Rights: Implementing the United Nations "Protect, Respect and Remedy" Framework' (UNGPs) (2011) HR/PUB/11/04.

2 John Ruggie, 'Interim Report of the SR of the SG on the Issue of BHRs and Other Business Enterprises' (2006) E/CN.4/2006/97.

3 UNGPs, 1.

4 Ibid, 17-24.

This risk-based approach, especially when mandated by legislation, offers a middle-road solution to the challenge of regulating business activities in relation to human rights by requiring that processes are carried out to assess and mitigate risks without prescribing them in too much detail. The method is suitable for dealing with the question of human rights for companies, which prefer flexibility and as little regulation as possible, and governments, which have a duty to protect human rights while at the same time fostering economic growth. However, the approach can also have downsides depending on how serious companies are in their efforts to carry out risk assessments based on human rights concerns and then incorporate those findings into their management systems. Thus, the question remains how the use of human rights due diligence impacts the ones it was meant to protect: people affected by business activities on the ground.

### **The Purpose of the Research**

The European Union, an avid supporter of the UNGPs, has been among those turning to mandatory human rights due diligence in a growing number of sectors. The aim of the present thesis is to provide an analysis of the existing pieces of EU legislation that enshrine the notion of due diligence, and when applicable, human rights due diligence specifically. As the EU is the world's largest trading block catering to 500m consumers,<sup>5</sup> regulatory measures on companies imposed at Union level have far-reaching implications worldwide. Because of its aims, which are both political and economic, and structure, which entails the single market, the EU is uniquely placed to take up human rights due diligence and affect change in global business.

The EU has recognised that respect for human rights in business is important to uphold the values the Union is built on and also contributes to sustainable growth of the European economy. Given the conferral of competences and the principle of subsidiarity, which underpin the functioning of the EU, taking concerted action at Union level is a unique avenue to enhance the adoption of human rights considerations for businesses. For this reason, while national governments are the ultimate duty-bearers tasked with upholding human rights, the present study will focus on human rights due diligence at the EU level. Given the different levels of protection available under national laws, it is possible that certain EU member states ensure higher levels of protection than granted under Union legislation. With the possible adoption of a treaty on business and human rights<sup>6</sup> in the future, international protections might also play a larger role in the issue. However,

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5 European Commission, 'EU Position in World Trade' (last updated 18 February 2019) <<http://ec.europa.eu/trade/policy/eu-position-in-world-trade/>> accessed 26 June 2019.

6 Human Rights Council, 'Resolution Adopted by the Human Rights Council: 26/9 Elaboration of an International Legally Binding Instrument on Transnational Corporations and Other Business Enterprises with Respect to Human Rights' (14 July 2014) A/HRC/RES/26/9.

protections under solely national legislation and a possible treaty will not be discussed in the present study.

To date, no analysis has been carried out comparing and contrasting EU legislative acts on due diligence. The inspiration for discussing due diligence at an EU level comes from a 2015 European Commission document that calls for a side-by-side analysis of existing legislation to help ‘identify good ideas and allow some general recommendations to be developed for application in other areas’.<sup>7</sup> Notably, the EU is in the process of considering whether mandatory supply chain due diligence would be a suitable measure to take.<sup>8</sup> Thus, the main aim of the present study is to draw conclusions based on the current EU laws with due diligence aspects with a view to identifying best practices for a possible supply chain due diligence legislation in the future.

The main research questions of the study are as follows:

1. What does the notion of due diligence mean from the perspective of human rights?
2. How successful have current EU due diligence legislative acts been in achieving their stated goals, especially as they relate to human rights?
3. What lessons can be drawn for future due diligence legislation by the EU?

The first question aims to analyse the notion of human rights due diligence in abstract terms to see how the practice of due diligence can be combined with human rights. This discussion involves mainly philosophical issues, examining fundamental views on the supremacy of human rights over economic considerations. Answering the second question entails taking a closer look at existing EU laws individually to provide examples and feedback on the practical implications of using human rights due diligence. The pieces of legislation analysed are the EU’s Timber Regulation,<sup>9</sup> Non-Financial Reporting Directive<sup>10</sup> and Conflict Minerals Regulation.<sup>11</sup> Finally, the third question aims

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7 European Commission, ‘Commission Staff Working Document on Implementing the UN Guiding Principles on Business and Human Rights – State of Play’ SWD (2015) 144 final, 34.

8 European Commission, ‘Communication from the Commission – Action Plan: Financing Sustainable Growth’ COM (2018) 97 final.

9 Regulation (EU) No 995/2010 of the European Parliament and of the Council of 20 October 2010 laying down the obligations of operators who place timber and timber products on the market [2010] OJ L 295/23.

10 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 [2014] OJ L 330/1.

11 Regulation (EU) 2017/821 of the European Parliament and of the Council of 17 May 2017 laying down supply chain due diligence obligations for Union importers of tin, tantalum and tungsten, their ores, and gold originating from conflict-affected and high-risk areas [2017] OJ L 130/1.



to summarise the takeaways from the above analyses as they relate to possible future legislation, specifically, mandatory supply chain due diligence.

The hypothesis is that human rights due diligence is an attractive tool with much potential, however, if its parameters are not defined clearly enough, there's much room for it being used ineffectively – or, in the worst-case scenario, maliciously. Thus, there's probably a need for basic requirements to be relatively well defined, especially when part of mandatory human rights due diligence legislation. Studying the EU laws is meant to highlight areas where due diligence is described in terms that can lead to effective outcomes and areas where it doesn't. With a view to future legislation, especially mandatory supply chain due diligence, the success of any measure is hypothesised to be dependent on the EU's willingness to describe human rights due diligence in as clear terms as possible, and ensure strict and uniform enforcement throughout the Union and beyond.

## **Methods**

The study is built on desk-based research that aims to provide as current and deep an analysis as possible. Given the difficulties involved in analysing EU-wide laws that have been adopted within the past decade, the study will draw on existing European Commission reports on the implementation of given legislation, where possible. Additionally, the study utilises reports and analyses by civil society organisations; interviews with experts; and in some cases, brief case studies aimed at showing the impact of a certain law or pointing out some features. All throughout, the main goal is to reach conclusions about the efficacy of the legislative acts as they relate to their stated aims and, as far as feasible, to the improvement of respect for human rights on the ground. These conclusions will then be taken into account when making recommendations on what considerations could be useful when developing future legislation involving due diligence.

The scope of the study is narrow in the sense that it does not try to generate new information pertaining to the implementation of the EU legislation in question on a practical level. Rather, the aim is to identify certain main themes and trends that give insight into the use of due diligence. The novelty of the research also lies in analysing the three pieces of EU legislation side by side to show different approaches to legislating due diligence.

## **Structure**

In Chapter 1, the analysis takes a deep dive into the development and nature of human rights due diligence including a general discussion on the challenge of incorporating business and human

rights, the creation and implementation of the UNGPs, the notion of human rights due diligence enshrined in the UNGPs, and the EU's progress on taking up the UNGPs, including due diligence. Chapters 2 through 4 examine the three existing EU laws, which present different aspects of how due diligence can be enshrined in binding measures, starting with the Non-Financial Reporting Directive, which requires mandatory disclosures of non-financial information – including human rights due diligence processes – from certain large companies. The following chapter discusses the Timber Regulation, which requires EU timber importers to exercise due diligence in an effort to stem the flow of illegally harvested wood products from entering the EU market. Lastly, the main features of the Conflict Minerals Regulation – which is scheduled to fully come into effect in 2021 – are considered as the first EU legislation mandating expressly human rights due diligence. The Conclusions aim to draw out some of the main themes identified and make recommendations towards further legislation involving due diligence.

# Chapter 1: The Background of Human Rights Due Diligence

## 1.1 Introduction

The relationship between business and human rights has increasingly come under the spotlight over the past few decades, sadly, mainly as the result of major environmental catastrophes and serious abuses linked to companies. The fact that human rights standards need to apply to business operations is clear – the question, however, is how. After a series of failed attempts to define the human rights responsibilities of businesses, the international community, under UN-auspices, agreed on a non-binding guidance laying out the main principles underpinning the relationship between business and human rights. The document, known as the United Nations Guiding Principles on Business and Human Rights (UNGPs), explains that while states are the ultimate duty-bearers, businesses have a responsibility to respect human rights, which is operationalised through the use of human rights due diligence.<sup>12</sup>

The notion of human rights due diligence was developed to reduce the occurrence of human rights violations by businesses through framing the issue in terms of risk management. The UNGPs lay out some main components of human rights due diligence that companies should take into account when designing and implementing such processes, while at the same time leaving much flexibility for businesses to develop mechanisms that allow them to mitigate human rights risks in the most effective way. This approach aims to strike a fair balance between ensuring respect for human rights and minimising regulatory burdens on companies.

After decades of relying on voluntary measures and self-regulation by businesses, legislators have also started looking to mandatory human rights due diligence as a way to crack down on human rights violations by companies without imposing overly restrictive measures. The European Union has been one of the world leaders when it comes to including due diligence in legislation. With increased momentum behind the development of more similar measures, the notion of human rights due diligence and how it came to be are worth a closer look. The present chapter examines the development of the UNGPs and, in particular, human rights due diligence; provides a critical assessment of its nature; and describes why and how the EU has taken up the recommendation to use human rights due diligence.

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12 United Nations, ‘Guiding Principles on Business and Human Rights: Implementing the United Nations “Protect, Respect and Remedy” Framework’ (UNGPs) (2011) HR/PUB/11/04.

## 1.2 The Relationship Between Business and Human Rights

Businesses traditionally fell outside the purview of human rights, which grew out of the ashes of the Second World War aiming to curb states' power over their people. Instead, businesses have long been regulated domestically by governments. In the Western world, especially in the second half of the 20<sup>th</sup> century, that often meant having the fewest regulations possible to ensure that the market can operate freely and profits can be maximised. Friedman famously declared in 1970 that the only 'social responsibility' a company had was to 'increase its profits' and business leaders who claimed that their companies wanted to promote social well-being were 'unwitting puppets of the intellectual forces that have been undermining the basis of a free society these past decades'.<sup>13</sup>

However, global thinking over the issue has changed significantly in the past decades as news of human rights violations by companies have shocked people around the world. Since the 1980s, companies have increasingly come under fire for their human rights records. Some of the worst and most notorious violations linked to business activity have included the 1984 industrial accident in Bhopal, India, where 30 tons of toxic gas was released at a pesticide plant affecting 600,000 people, including killing as many as 16,000.<sup>14</sup> In 2013, more than 1,100 people working at garment factories were killed when a shabbily constructed building, known as Rana Plaza, collapsed in Dhaka, Bangladesh.<sup>15</sup> The factories housed in Rana Plaza produced goods for internationally-recognized brands including Benetton and Mango.<sup>16</sup> Currently, there is a case pending before a Dutch court against Shell for the company's alleged complicity in grave human rights abuses against Ogoni people by the Nigerian government.<sup>17</sup> Shell is accused of being complicit in the Nigerian government executing nine human rights activists for their peaceful protest against oil exploitation in the Niger Delta region, which had inflicted severe environmental damage.

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13 Milton Friedman, 'The Social Responsibility of Business Is to Increase Its Profits' *The New York Times* (13 September 1970) <<https://graphics8.nytimes.com/packages/pdf/business/miltonfriedman1970.pdf>> accessed 20 May 2019.

14 Alan Taylor, 'Bhopal: The World's Worst Industrial Disaster, 30 Years Later' *The Atlantic* (2 December 2014) <<https://theatlantic.com/photo/2014/12/bhopal-the-worlds-worst-industrial-disaster-30-years-later/100864/>> accessed 21 June 2019.

15 International Labour Organization, 'The Rana Plaza Accident and Its Aftermath' <[https://www.ilo.org/global/topics/geip/WCMS\\_614394/lang--en/index.htm](https://www.ilo.org/global/topics/geip/WCMS_614394/lang--en/index.htm)> date accessed 20 May 2019.

16 Clean Clothes Campaign, 'Rana Plaza: A Man-Made Disaster That Shook the World' (date published not available) <<https://cleanclothes.org/ua/2013/rana-plaza>> accessed 21 June 2019.

17 Rod Austin, 'Ogoni Widows Testify at The Hague over Shell's Alleged Complicity in Killings' *The Guardian* (12 February 2019) <<https://www.theguardian.com/global-development/2019/feb/12/ogoni-widows-testify-the-hague-shell-alleged-complicity-killings>> date accessed 20 May 2019. See also *Kiobel v Royal Dutch Petroleum Co* [2013] 569 US 108 on the failed attempt to seek justice for the Ogoni people in US courts under the country's Alien Tort Statute. The US Supreme Court rejected the extraterritorial application of the statute.

While the problems are obvious, the answers are less so. As the above-mentioned examples show, business-related human rights violations are often linked to multinational corporations that operate across several jurisdictions. Globalisation has transformed companies into powerful global players with significant leverage against governments and far-reaching impacts on peoples' lives worldwide.<sup>18</sup> As Wetzel pointed out, companies are neither 'malevolent machines set out to destroy humanity', nor do they 'stand above all duties towards the society they operate in', which means that defining their relationship to human rights 'is much more complex than any single answer could ever hope to be'.<sup>19</sup> Deciding how to address the issue taps into individuals' deeply-held beliefs about the role of governments and markets, ethics, morality and the nature of human rights.

The public perception of corporate responsibilities is evolving rapidly and is converging on the need for companies to demonstrate concern for human rights. However, that brings up a host of questions about how human rights, which were developed to define the relationship between states and individuals, can be applied to private entities. Bishop has outlined the theoretical foundations for why companies need to take human rights into account listing three main approaches: the deontological view, which requires all 'agents capable' of respecting human rights to do so; the utilitarian view, which ties companies' obligations to their size and power; and finally, the view that businesses have a 'social contract' with the societies that they operate in and thus owe it to them to respect human rights.<sup>20</sup> However, as he noted, none of these approaches leads to an exact definition of the extent and nature of human rights obligations that companies have, mainly because the human rights system has been developed for states and not for companies.

The place of businesses in the international human rights system, especially with the emergence of globalisation, has been the subject of fierce debates. On one hand, experts have argued for an expansion of businesses' - especially transnational companies' (TNCs) - obligations to respect human rights. De Schutter has argued that not violating human rights was the bare minimum and instead, the objective should be 'transforming TNCs into instruments for a more humane kind of globalization, one which not only respects the full set of internationally recognized human rights, but which also ensures that they will be further realized, in combination with economic growth'.<sup>21</sup> According to De Schutter, companies cannot be satisfied with the 'micro' view of making sure that their actions don't have a direct negative impact on human rights, rather, they need to take a 'macro'

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18 George G Brenkert, 'Business Ethics and Human Rights: An Overview' (2016) 1 *Business and Human Rights Journal* 277.

19 Julia Ruth-Maria Wetzel, *Human Rights in Transnational Business: Translating Human Rights Obligations into Compliance Procedures* (Springer International Publishing Switzerland 2016) 261.

20 John Douglas Bishop, 'The Limits of Corporate Human Rights Obligations and the Rights of For-Profit Corporations' (2012) 22 *Business Ethics Quarterly* 119, 122.

21 Olivier De Schutter, 'Transnational Corporations as Instruments of Human Development' in Philip Alston and Mary Robinson (eds), *Human Rights and Development: Towards Mutual Reinforcement* (OUP 2005) 404.

view to evaluate the impact of their presence on any given country's right to development.<sup>22</sup> This means companies would have to consider the political situation in the host country and whether their decision to outsource certain processes to that country would contribute to rising global and local inequalities, for example.

Others have warned against companies assuming such wide-ranging human rights responsibilities, especially political engagement. Werhane, using the above-mentioned example of Shell and the Ogoni people, questioned whether Shell had an obligation to interfere with the actions of the Nigerian government, acknowledging nevertheless that it was 'impossible' to defend all of the company's actions.<sup>23</sup> She wrote,

Despite media and public outcries criticizing their [Shell's] non-interference in the treatment of the Nigerian dissidents, such interference would have 'smelled' like neo-colonialism, no matter how well-meaning or effective it would have been. Thus one has to take care in ascribing too much in the way of obligations ... to firms, particularly when they have the finances and power to 'improve' human rights conditions in a host country.<sup>24</sup>

Werhane concluded that companies' obligations and corresponding rights, which she argued were necessary for carrying out human rights obligations, should be 'restricted to economic, not political engagements'.<sup>25</sup>

Complicating the issue is also the global nature of business, with supply chains often spanning across the world. This means that human rights violations are often committed by or connected to operations of companies headquartered in other countries. When such violations occur, the question of extraterritoriality comes into play. Depending on the situation, the company might be bound by different legal regimes, for example, differences might exist between the home and host states. This issue brings up a host of questions – both practical and legal. Solving this is another one of the ongoing challenges.<sup>26</sup>

In practice, what it all comes down to is a choice governments have to make between regulation and voluntary measures. Regulating business has traditionally been viewed as highly undesirable both by the private sector and those in favour of free-market capitalism. This has been

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22 Ibid, 405.

23 Patricia H Werhane, 'Corporate Moral Agency and the Responsibility to Respect Human Rights in the UN Guiding Principles: Do Corporations Have Moral Rights?' (2016) 1 Business and Human Rights Journal 5, 18.

24 Ibid.

25 Ibid, 19.

26 For principles developed by notable experts on extraterritoriality, see 'Maastricht Principles on Extraterritorial Obligations of States in the Area of Economic, Social and Cultural Rights' (28 September 2011).

evident in the failure to adopt any binding international instrument so far on business and human rights, even though, efforts had started as early as the 1970s at the United Nations to lay down guidance. However, the 1983 draft ‘UN Code of Conduct on Transnational Corporations’ and the 2003 ‘Norms on the Responsibilities of Transnational Corporations and Other Business Enterprises with Regard to Human Rights’ were snuffed out amid fierce opposition by both governments and businesses.<sup>27</sup> At the same time, voluntary initiatives, such as the UN Global Compact, have brought negligible results. The Global Compact, which is a corporate sustainability initiative, has long been criticised for being a set of mere voluntary measures lacking any effective monitoring mechanism and for allowing companies to use the initiative as a public relations exercise while continuing to perpetrate human rights violations.<sup>28</sup>

It was in this context that John Ruggie, a Harvard professor and one of the chief architects of the UN Global Compact, was appointed UN Special Representative of the Secretary-General on Business and Human Rights (SRSG) in 2005. His mandate was to take stock of existing standards and identify best practices that could lead the way forward.<sup>29</sup> In an interim report presented a year later, Ruggie committed himself in his role as SRSG to practice a ‘principled form of pragmatism’, which he described as:

[A]n unflinching commitment to the principle of strengthening the promotion and protection of human rights as it relates to business, coupled with a pragmatic attachment to what works best in creating change where it matters most – in the daily lives of people.<sup>30</sup>

This approach led to the creation of the United Nations Guiding Principles on Business and Human Rights, which has emerged as one of the most highly-regarded normative frameworks achieving wide-ranging international acceptance.

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27 Patricia Feeney, ‘Business and Human Rights: The Struggle for Accountability in the UN and the Future Direction of the Advocacy Agenda’ (2009) 6(11) *Sur Revista Internacional de Direitos Humanos* 160.

28 Jo Confino, ‘Cleaning up the Global Compact: Dealing with Corporate Free Riders’ *The Guardian* (26 March 2012) <<https://theguardian.com/sustainable-business/cleaning-up-un-global-compact-green-wash>> accessed 24 June 2019.

29 Commission on Human Rights, ‘Human Rights and Transnational Corporations and Other Business Enterprises’ (20 April 2005) Human Rights Resolution 2005/69.

30 John Ruggie, ‘Interim Report of the SR of the SG on the Issue of BHRs and Other Business Enterprises’ (2006) E/CN4/2006/97, 20.

### 1.3 The UN Guiding Principles on Business and Human Rights

Ruggie's work as SRSG culminated in the publication of the UNGPs in 2011, which was later that year endorsed<sup>31</sup> by the UN Human Rights Council. The document extrapolated the UN's 'Protect, Respect and Remedy framework' to business and human rights, taking the following principles as its basis:

- (a) States' existing obligations to respect, protect and fulfil human rights and fundamental freedoms;
- (b) The role of business enterprises as specialized organs of society performing specialized functions, required to comply with all applicable laws and to respect human rights;
- (c) The need for rights and obligations to be matched to appropriate and effective remedies when breached.<sup>32</sup>

Based on these principles, Ruggie laid out states' 'duty to protect human rights', the 'corporate responsibility to respect human rights' and the need for 'access to remedy' as the main pillars of the global human rights architecture as it applies to business.<sup>33</sup> Ruggie called these pillars 'distinct but complementary'.<sup>34</sup>

In the first principle, the UNGPs reaffirm that states are the sole duty-bearers responsible for upholding human rights. States need to take 'appropriate steps to prevent, investigate, punish and redress' human rights abuses 'through effective policies, legislation, regulations and adjudication'.<sup>35</sup> The UNGPs point out that states are not '*per se* responsible' for human rights violations carried out by third parties, which in this case would be private companies, however, it might be a breach of states' international human rights obligations if they failed to take appropriate action to prevent or punish such abuses.<sup>36</sup> The UNGPs note that the exception to this principle is when a state is directly involved in business activities through owning or controlling enterprises, providing companies with 'substantial support and services', or contracting with private companies

31 Human Rights Council, 'Resolution: Human Rights and Transnational Corporations and Other Business Enterprises' (6 July 2011) A/HRC/RES/17/4.

32 UNGPs, 1.

33 Ibid.

34 John Ruggie, 'Report of the Special Representative of the Secretary-General on the Issue of Human Rights and Transnational Corporations and Other Business Enterprises, John Ruggie,' (9 April 2010) A/HRC/14/27, 3.

35 UNGPs, 3.

36 Ibid.



for the delivery of public services.<sup>37</sup> In such cases, human rights violations occurring during the course of business activities ‘may entail a violation of the State’s own international law obligations’.<sup>38</sup>

It is important to note here that Ruggie chose to use the term ‘duty’ when talking about states to delineate the nature of obligations from those of companies, which have a ‘responsibility’ to respect human rights. The duty to protect people from human rights abuses by companies derives from states’ ‘legal obligation through their ratification of legally binding international human rights treaties containing provisions to this effect’.<sup>39</sup> Conversely, the responsibility of businesses to respect human rights is ‘a minimum expectation’ towards companies that is often reflected in domestic legislation – though, not in all cases.<sup>40</sup> This means that while the duties of states are rooted in international human rights instruments, the responsibilities for businesses are somewhat less binding and are reliant on domestic legislation to have legal effect.

Under the second pillar, corporations have a responsibility to respect human rights, which the UNGPs define as companies having to ‘avoid infringing on the human rights of others’ and ‘address adverse human rights impacts with which they are involved’.<sup>41</sup> These responsibilities should be met even in the absence of states’ willingness or ability to fulfil their own human rights obligations. Human rights are defined at the minimum as the International Bill of Human Rights, which is an internationally recognized set of binding and non-binding instruments, and the International Labour Organization’s *Declaration on Fundamental Principles and Rights at Work*.<sup>42</sup>

Finally, the third pillar seeks to ensure access to remedy for victims when human rights violations do occur. Here, again, the onus is on states to ‘take appropriate steps to ensure, through judicial, administrative, legislative or other appropriate means, that ... those affected have access to effective remedy’.<sup>43</sup> The UNGPs lay out a catalogue of grievance mechanisms, including judicial and non-judicial options, and both state and non-state processes. Additionally, companies are also called on to participate in remediation processes under pillar two.<sup>44</sup>

The principles were created following a highly inclusive consultation process to ensure that all stakeholders, including businesses, would be on board.<sup>45</sup> The principles are entirely voluntary

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37 Ibid, 6-8.

38 Ibid, 7.

39 United Nations, ‘Frequently Asked Questions about the Guiding Principles on Business and Human Rights’ (2014) HR/PUB/14/3, 9.

40 Ibid.

41 UNGPs, 13.

42 Ibid, 14.

43 Ibid, 27.

44 Ibid, 24.

45 Ruggie (n 34) 4.

and did not create any new legal obligations.<sup>46</sup> Thus, Ruggie chose to sacrifice the chance to create a binding instrument in order to increase the possible reach and impact of the principles. This approach, which led to defining the relationship between business and human rights in terms of a mixture of voluntary and mandatory measures, has been praised for its innovative nature.<sup>47</sup> Others were less keen on this ‘smart mix’ approach because it kept the main duty to protect human rights on the states, which had always been the case and had been deemed a failure to begin with.<sup>48</sup>

#### 1.4 The Implementation of the UNGPs

The main means towards the implementation of the UNGPs has been the creation of National Action Plans (NAPs) outlining states’ domestic measures on business and human rights. The call to develop such national plans first came from the European Union,<sup>49</sup> which was soon followed by the UN Human Rights Council.<sup>50</sup> To date, 21 countries have submitted NAPs, 16 of which are EU member states.<sup>51</sup> NAPs are considered as soft-law instruments, specifically ‘new governance’ tools, which help states formulate general policy directions in complex areas without having to create legal obligations.<sup>52</sup>

The creation of NAPs as a means to implement the UNGPs has received mixed reactions. On one hand, the process can contribute to better national policy alignment with international human rights standards and can also lead to greater transparency, more inclusive dialogue and a basis to hold governments accountable for their business and human rights record.<sup>53</sup> On the other hand, NAPs can be seen as a ‘convenient fig leaf’ to cover up governments’ unwillingness to adopt binding legislation for fear of putting their national businesses at a disadvantage.<sup>54</sup> There’s also the possibility of corporations using the consultation processes to further their own interests.<sup>55</sup>

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46 UNGPs, 1.

47 Karin Buhmann, ‘Business and Human Rights: Understanding the UN Guiding Principles from the Perspective of Transnational Business Governance Interactions’ (2015) 6 *Transnational Legal Theory* 399, 432.

48 Florian Wettstein, ‘Normativity, Ethics, and the UN Guiding Principles on Business and Human Rights: A Critical Assessment’ (2015) 14 *Journal of Human Rights* 162, 166.

49 European Commission, ‘A Renewed EU Strategy 2011-14 for Corporate Social Responsibility’ COM (2011) 681 final.

50 Human Rights Council, ‘Resolution: Human Rights and Transnational Corporations and Other Business Enterprises’ (15 July 2014) A/HRC/RES/26/22.

51 UN Office of the High Commissioner for Human Rights, ‘State National Action Plans on Business and Human Rights’ (date published not available) <[www.ohchr.org/en/Issues/Business/Pages/NationalActionPlans.aspx](http://www.ohchr.org/en/Issues/Business/Pages/NationalActionPlans.aspx)> accessed 20 May 2019.

52 Claire Methven O’Brien and others, ‘National Action Plans: Current Status and Future Prospects for a New Business and Human Rights Governance Tool’ (2015) 1 *Business and Human Rights Journal* 117, 119.

53 *Ibid.*, 121.

54 *Ibid.*

55 *Ibid.*

While the global process to develop NAPs is still in its early stages, analyses of existing plans have identified both positive trends and shortcomings in the drafting processes and contents of the plans. According to a comprehensive study released in 2017 analysing the then-available 17 NAPs, countries undertaking the process involved a wide range of government entities and also included consultations with other stakeholders, which are positive steps because they foster dialogue on the issue.<sup>56</sup> For example, in Finland, the working group tasked with drafting the NAP comprised of representatives from several ministries and held two public hearings to include views from various stakeholders.<sup>57</sup> However, the study noted that the processes by large still lacked transparency and most countries failed to conduct so-called national baseline assessments to establish points of reference for future action.<sup>58</sup> Only Italy and Norway had carried out proper national baseline assessments, which means that other countries developed NAPs without identifying existing gaps in legislation.<sup>59</sup>

In terms of the content, NAPs seemed to shy away from proposing new laws, rather, they tended to focus on voluntary measures.<sup>60</sup> For example, the Netherlands devoted two pages in its 44-page NAP to future actions, most of which were awareness-raising campaigns and trainings often lacking clarity and timelines.<sup>61</sup> The failure to pursue new regulation was especially visible in the case of ensuring access to remedy.<sup>62</sup> Norway committed merely to cooperating in regional and international initiatives on the issue, while the UK noted that it would continue supporting remedy procedures in other countries.<sup>63</sup> The future actions described were also often too vague,<sup>64</sup> and the plans also lacked real review or follow-up mechanisms.<sup>65</sup> For instance, the United States did not commit to any monitoring mechanism or review of its NAP, merely setting up a dedicated email address to receive ‘feedback and suggestions’ concerning the action plan.<sup>66</sup>

Besides the NAPs process, some governments and the EU have also adopted more hard-law instruments to implement the UNGPs. These include non-financial reporting requirements and mandatory human rights due diligence. As discussed in the following sections, the EU has adopted three pieces of legislation to date enshrining the notion of due diligence. France and the UK have

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56 ICAR, ECCJ and Dejusitica, *Assessment of Existing National Action Plans (NAPs) on Business and Human Rights* (2017) 3.

57 Ibid, 16.

58 Ibid, 4. Also see Damiano De Felice and Andreas Graf, ‘The Potential of National Action Plans to Implement Human Rights Norms: An Early Assessment with Respect to the UN Guiding Principles on Business and Human Rights’ (2015) 7 *Journal of Human Rights Practice* 40.

59 Ibid.

60 Ibid, 5.

61 Ibid, 11.

62 Ibid.

63 Ibid, 5.

64 Ibid.

65 Methven O’Brien and others (n 52) 125.

66 ICAR, ECCJ and Dejusitica (n 56) 282.

also been front-runners in incorporating due diligence into their national laws. Thus, legislating due diligence seems to be the main route for translating the UNGPs into binding measures.

## 1.5 The Definitions and Legal Basis of Due Diligence

There is no universally-accepted definition for due diligence: the idea can be found in several different areas of law, namely, corporate law and international law, including international environmental and human rights law. The concept has different meanings depending on the context, and understanding how these areas and different applications come together in human rights due diligence is essential to getting a full picture.

The concept of due diligence as it applies to business originates from the US Securities Act of 1933.<sup>67</sup> As section 11(b)(3) of that legislation states, having conducted due diligence on the issuer of securities can be used by broker-dealers as legal defence when they are accused of not having adequately disclosed material information to investors. If broker-dealers can demonstrate that the missing information had not been discovered despite having conducted a due diligence investigation in good faith, they can avoid legal liability. The scope of due diligence in this sense has since been extended to become ‘a way of preventing damage or unnecessary harm’<sup>68</sup> that is built on the importance of carrying out thorough investigations<sup>69</sup> as a means of risk management. As Martin-Ortega put it, the purpose of due diligence is to ‘confirm facts, data and representations involved in a commercial transaction in order to determine the value, price and risk of such transactions, including the risk of future litigation’.<sup>70</sup> This kind of corporate due diligence has become the norm in many areas of business activities, such as mergers and acquisitions, initial public offerings and fighting anti-corruption.<sup>71</sup>

In international law, due diligence relates to states’ responsibility for wrongful acts. In a general sense, the failure to act with due diligence could open states up to legal liability for the acts of non-state actors, whereas states would otherwise be only responsible for their own actions or omissions.<sup>72</sup> For environmental protection, due diligence has been considered an integral part of the

<sup>67</sup> Securities Act of 1933 (US).

<sup>68</sup> Marco Fasciglione, ‘The Enforcement of Corporate Human Rights Due Diligence: From the UN Guiding Principles on Business and Human Rights to the Legal Systems of EU Countries’ (2016) 10 *Hum Rts & Int’l Legal Discourse* 103.

<sup>69</sup> Mark B Taylor, Luc Zandvliet and Mitra Forouhar, ‘Due Diligence for Human Rights: A Risk-Based Approach’ (2009) Corporate Social Responsibility Initiative Working Paper 53  
<[https://www.hks.harvard.edu/sites/default/files/centers/mrcbg/programs/cr/ri/files/workingpaper\\_53\\_taylor\\_etal.pdf](https://www.hks.harvard.edu/sites/default/files/centers/mrcbg/programs/cr/ri/files/workingpaper_53_taylor_etal.pdf)> accessed 24 June 2019.

<sup>70</sup> Olga Martin-Ortega, ‘Human Rights Due Diligence for Corporations: From Voluntary Standards to Hard Law at Last’ (2014) 32 *Netherlands Quarterly of Human Rights* 44, 51.

<sup>71</sup> Fasciglione (n 68).

<sup>72</sup> Rashida Manjoo, ‘Report of the Special Rapporteur on Violence Against Women, Its Causes and Consequences, Rashida Manjoo’ (14 May 2013) A/HRC/23/49, 4.

‘no-harm rule’, which requires states to ensure that they do not cause environmental damage beyond their national jurisdiction.<sup>73</sup> As Fasciglione explained, the no-harm rule is breached only when a state has demonstrably not acted with due diligence, which means that it did not try to prevent foreseeable damage or minimise such risks.<sup>74</sup>

When it comes to international human rights law, the treaty system under UN-auspices lays out states parties’ obligations to respect, protect and fulfil human rights. Under the interpretations of human rights instruments developed by UN treaty bodies, the failure to act with due diligence has been seen as a breach of states’ duty to protect people from human rights violations. General Recommendation No. 19 adopted by the Committee on the Elimination of Discrimination Against Women for the first time stated that ‘States may also be responsible for private acts if they fail to act with due diligence to prevent violations of rights or to investigate and punish acts of violence’.<sup>75</sup> This means that a state can be held accountable for violations carried out by third parties unless the state can demonstrate that it acted with due diligence. A 2006 report by Yakin Ertürk, UN Special Rapporteur on violence against women, its causes and consequences, further elaborated on the principle in the context of women’s rights concluding that states’ ability to meet the due diligence standard depends on having a flexible reading of the given situation, which needs to take into account ‘the domestic context, internal dynamics, nature of the actors concerned and the international conjuncture’.<sup>76</sup> In practice, for example, this requires states to set up appropriate law enforcement mechanisms to protect women and girls when they’re known to be at risk of violations.

The UN Human Rights Committee later also adopted a similar approach on due diligence, specifying that states’ positive obligations under the International Covenant on Civil and Political Rights<sup>77</sup> include the protection of individuals’ rights when they are threatened by non-state actors. The Committee clarified the role of due diligence in a general comment on the nature of state obligations the following way:

There may be circumstances in which a failure to ensure Covenant rights ... would give rise to violations by States Parties of those rights, as a result of States Parties’ permitting or failing to take appropriate measures or to exercise due diligence to

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73 Fasciglione (n 68) 100.

74 Ibid.

75 Committee on the Elimination of Discrimination Against Women, ‘General Recommendation No 19: Violence Against Women’ (20 January 1992) contained in document A/47/38, para 9.

76 Yakin Ertürk, ‘Integration of the Human Rights of Women and the Gender Perspective: Violence Against Women, the Due Diligence Standard as a Tool For the Elimination of Violence Against Women, Report of the Special Rapporteur on Violence Against Women, its Causes and Consequences, Yakin Ertürk’ (20 January 2006) E/CN4/2006/61, 23.

77 United Nations, ‘International Covenant on Civil and Political Rights’ (adopted 16 December 1966) contained in UN General Assembly resolution 2200A (XXI).

prevent, punish, investigate or redress the harm caused by such acts by private persons or entities.<sup>78</sup>

This means that states must do everything in their power to prevent foreseeable violations of rights by non-state actors. For example, according to a subsequent general comment from 2018 by the Committee, in the case of the right to life, this requires states to take ‘reasonable positive measures, which do not impose on them disproportionate burdens, in response to reasonably foreseeable threats to life originating from private persons and entities, whose conduct is not attributable to the State’.<sup>79</sup> In practice, this requires states to crack down on criminal networks and organized crime, including terrorist groups. Additionally, states must also prevent risks to the right to life through ensuring adequate supervision of private entities such as hospitals, transportation companies and private security firms.<sup>80</sup>

Thus, in international law, the nature of due diligence is highly dependent on the context in which it is applied. However, it can be said that it is a standard of conduct with the common element that can be defined as a ‘*policy process* that a reasonable and prudent State needs to undertake to meet its responsibility to prevent violations’.<sup>81</sup>

## 1.6 Human Rights Due Diligence in the UNGPs

The novel approach taken by the UNGPs was merging the corporate concept of due diligence, which is a risk-management process, with the international human rights notion of the term, which is a standard of conduct, to create human rights due diligence as a means of operationalising businesses’ responsibility to respect human rights.<sup>82</sup> In a 2011 speech, Ruggie – borrowing an analogy from Andrew Vickers, a former vice president for Shell – said that human rights due diligence was the equivalent of ‘social seismic skills’. Ruggie said, ‘No petroleum or mining engineer ... would dream of drilling a hole in the ground without first conducting extensive seismic analysis.’ The same way, companies need to conduct analyses on the social impact of their activities.<sup>83</sup>

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78 Human Rights Committee, ‘General Comment No 31: The Nature of the General Legal Obligation Imposed on States Parties to the Covenant’ (29 March 2004) CCPR/C/21/Rev1/Add 13, para 8.

79 Human Rights Committee, ‘General Comment No 36 on Article 6 of the International Covenant on Civil and Political Rights, on the Right to Life’ (30 October 2018) CCPR/C/GC/36, para 21.

80 Ibid.

81 Fasciglione (n 68) 103.

82 UNGPs, 17.

83 John Ruggie, ‘Speech: Sir Geoffrey Chandler Speaker Series at The Royal Society for the Encouragement of Arts, Manufacturers and Commerce’ (London, 11 January 2011).

The UNGPs don't expand extensively on the nature and definition of due diligence, however, they do specify that any such mechanism needs to include the identification and mitigation of human rights impacts, which then need to be tracked and clearly communicated to the public, especially to affected individuals. The principles recommend integrating human rights due diligence into risk-management systems, noting, however, that the risks here should include those to rights-holders and not just to the company itself.<sup>84</sup> The UNGPs clarify that conducting human rights due diligence can help companies defend themselves against the risk of legal claims,<sup>85</sup> nevertheless, the mere existence of due diligence mechanisms is not enough to 'automatically and fully absolve' any given company of committing human rights abuses.<sup>86</sup>

A 2012 interpretive guide on the UNGPs uses the following legal definition for due diligence in general:

[S]uch a measure of prudence, activity, or assiduity, as is properly to be expected from, and ordinarily exercised by, a reasonable and prudent [person] under the particular circumstances; not measured by any absolute standard, but depending on the relative facts of the special case.<sup>87</sup>

In the context of human right due diligence, this signifies an 'ongoing management process that a reasonable and prudent enterprise needs to undertake, in the light of its circumstances (including sector, operating context, size and similar factors) to meet its responsibility to respect human rights'.<sup>88</sup> The document further explains the elements of human rights due diligence as processes that 'provide the management of any enterprise with the framework it needs in order to know and show that it is respecting human rights in practice'.<sup>89</sup>

As for the elements that any human rights due diligence mechanism needs to include, the UNGPs list five main points. The first one is identifying and assessing possible human rights violations as a consequence of companies' 'own activities or as a result of their business relationships'.<sup>90</sup> This must include an investigative process using internal and external experts and consultations with various stakeholders. The second step calls for the prevention and mitigation of

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84 UNGPs, 18.

85 Ibid.

86 Ibid, 19.

87 *Black's Law Dictionary* (6th edn, 1990) as quoted in United Nations, 'The Corporate Responsibility to Respect Human Rights: An Interpretive Guide' (2012) HR/PUB/12/02, 6.

88 United Nations, 'The Corporate Responsibility to Respect Human Rights: An Interpretive Guide' (2012) HR/PUB/12/02.

89 Ibid, 32.

90 UNGPs, 19.

possible human rights violations by translating the results of the assessment into actions.<sup>91</sup> This requires ‘effective integration’ of the findings into the company’s decision-making process followed by ‘appropriate action’ based on how directly the company is linked to the (possible) violation.<sup>92</sup> Thirdly, companies must keep track of their method of preventing or mitigating negative human rights impacts through the use of precise indicators and feedback from various sources.<sup>93</sup> The fourth step is clearly communicating the way human rights impacts are managed, especially to affected stakeholders.<sup>94</sup> Finally, when human rights due diligence has shown companies to be involved in human rights violations, they should take part in providing remedy, including by engaging with judicial processes.<sup>95</sup>

Following the adoption of the UNGPs, the Organisation for Economic Co-operation and Development (OECD) also embraced the notion of due diligence, developing its own guidance, which stayed mainly along the lines of the UNGPs. The main difference is that the *OECD Due Diligence Guidance for Responsible Business Conduct* lists embedding human rights into policies and decision-making processes as the very first step,<sup>96</sup> which the UNGPs include under a separate heading but note nonetheless as essential for effective due diligence.

## 1.7 The Nature of Human Rights Due Diligence

Given the lack of a precise definition or framework for conducting human rights due diligence, coupled with the multifaceted goals of applying such mechanisms, a number of questions – both practical and theoretical – arise. The way companies think about these issues can have a significant impact on their due diligence process and its outcomes. In fact, in the most extreme cases, human rights due diligence can be used as a cynical box-ticking exercise or even as a means for gauging stakeholders’ leverage to decide whose human rights can be undermined with the least amount of risk. Thus, the nature of human rights due diligence requires a closer examination.

Conceptual gaps have been noted by critics as a main issue. Bonnitcha and McCorquodale argued that the due diligence model described in the UNGPs mixed the two different meanings of the concept – which can be understood both as a risk management tool and a standard of conduct – without explaining the relationship between the different meanings.<sup>97</sup> This can create significant

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91 Ibid, 20.

92 Ibid, 20-21.

93 Ibid, 22.

94 Ibid, 23.

95 Ibid, 24.

96 OECD, *OECD Due Diligence Guidance for Responsible Business Conduct* (2018) 16-17.

97 Jonathan Bonnitcha and Robert McCorquodale, ‘The Concept of “Due Diligence” in the UN Guiding Principles on Business and Human Rights’ (2017) 28 *The European Journal of International Law* 899.



confusion. The authors warned that this could lead companies to the ‘incorrect view that implementing due diligence processes is sufficient to discharge [their] responsibility to respect human rights’.<sup>98</sup> Additionally, this confusion can complicate delineating when a business has violated its responsibilities:

If due diligence, understood as a standard of conduct, applies, then a business is only responsible for adverse human rights impacts that result from its failure to act with reasonable diligence. ... In contrast, if businesses breach their responsibility to respect human rights whenever they infringe human rights – that is, if the responsibility to respect human rights is akin to a strict liability standard and does not entail a fault element – then a business’s responsibility to redress situations in which it has infringed human rights is independent of any debate about whether the business has acted with sufficient diligence or care. On this interpretation, a business enterprise is responsible for all of its adverse human rights impacts regardless of whether those impacts were unexpected or costly to prevent.<sup>99</sup>

Bonnitcha and McCorquodale proposed clarifying the due diligence approach by differentiating human rights violations caused directly by companies’ actions and those caused by third parties they have business relations with.<sup>100</sup> In the former case, a strict responsibility should apply disregarding due diligence as a standard of conduct, and it should be only in the latter case that due diligence could be seen as a company discharging its human rights responsibility.<sup>101</sup> This view takes a stronger approach to due diligence than intended by the UNGPs by urging that the use of due diligence as legal defence be abandoned in cases where companies are directly liable for human rights violations.

Analysing the due diligence model along similar lines, FASTERLING and DEMUIJNCK argued that the approach doesn’t require companies to treat human rights as a perfect moral duty.<sup>102</sup> This means that if a business’ leadership doesn’t accept human rights as ‘absolute moral constraints’,<sup>103</sup> they might leverage human rights against economic considerations throughout the due diligence process. Whereas if human rights were to be treated as a perfect duty, questions would arise only about

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98 Ibid, 910.

99 Ibid, 911.

100 Ibid, 912.

101 Ibid.

102 Björn FASTERLING and Geert DEMUIJNCK, ‘Human Rights in the Void? Due Diligence in the UN Guiding Principles on Business and Human Rights’ (2013) 116 *Journal of Business Ethics* 799.

103 Ibid.

balancing different human rights against each other.<sup>104</sup> For example, using the above-discussed example of Shell's alleged complicity in the Nigerian government's killing of Ogoni activists, the death of those individuals (and Shell's ensuing legal troubles) cannot be balanced against the profit the oil company has made from exploiting Nigerian resources. Unless companies commit to respecting human rights as an absolute moral duty, due diligence becomes a means to protect companies against legal liability rather than a means to fulfil a perfect duty. Thus, given the limitations, due diligence can be used as a mere 'exculpation policy'.<sup>105</sup>

Additionally, using human rights due diligence as a purely risk management tool can also have negative consequences. A company can look at human rights due diligence in terms of social or reputational risk, meaning negative impacts on the company – including its bottom line – due to activities that are perceived in an unfavourable light by society.<sup>106</sup> In this case, risk management is a means to fulfil a fiduciary duty towards a company's stakeholders by making sure that profits are maximised. In such a scenario, Fasterling noted, looking at human rights violations purely as social risk might lead companies to consider the leverage certain affected stakeholders have in the situation.<sup>107</sup> For example, the leverage of affected stakeholders might be larger if they have the ability to attract media coverage or have political leaders that rally behind their cause. However, if that leverage is considered to be small or the fallout from violating human rights is seen as negligible, companies might, in fact, choose to go ahead with or continue harmful activities. In such cases, the due diligence process effectively becomes a tool to gauge the leverage of stakeholders and help companies decide which human rights can be violated. In this scenario, the due diligence process becomes not just a box-ticking exercise but rather a mechanism that can be used for even more sinister purposes.

Another argument that is often taken for granted is the so-called 'business case' for respecting human rights. As the thinking goes, violating human rights can hurt companies financially either through direct fines or dropping sales due to society's unfavourable view of the business, which is why acting with diligence makes the most sense on the long run. However, Fasterling here again warned against equating human rights risks with social risks noting, 'If this was true, there would be no need to have human rights issues determine corporate strategy, because respecting human rights would already be instrumental to achieving a corporation's value maximalization objective.'<sup>108</sup> In other words, if companies knew that respecting human rights was

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104 Ibid, 802.

105 Ibid, 809.

106 Björn Fasterling, 'Human Rights Due Diligence as Risk Management: Social Risk Versus Human Rights Risk' (2017) 2 Business and Human Rights Journal 225, 230.

107 Ibid, 235.

108 Ibid, 232.

financially prudent, they would be doing it already. Fasterling noted that the evidence to date was ‘quite thin’ that company value was strongly affected by human rights violations, nevertheless, urging for further research in the area.<sup>109</sup> Unless studies clearly show that respecting human rights has advantageous effects on bottom lines, making the business case for due diligence will be an uphill battle. This is especially the case given that such processes themselves impose significant financial and administrative burdens on companies, particularly smaller operations.

Thus, the real question becomes not whether or even how a company conducts human rights due diligence, but rather, what impact that process has on its decision-making. Is human rights due diligence used in the way it was intended in the UNGPs, or are companies just going through the motions? Is a company’s commitment to respecting human rights strong enough to trump all financial considerations? For this to be the case, a company – especially its leadership – must have a strong moral commitment to such values to the point that it is part of the company’s DNA on all levels of decision-making.<sup>110</sup> Leaving this up to companies and market forces – as has been the case traditionally – hasn’t eradicated human rights violations, which has recently led to increased willingness by governments to intervene. As most states have been reluctant to go further than recommended in the UNGPs, the most often used route to date has been making human rights due diligence a legal requirement for certain sectors and companies. The success of such legislation depends on how well they take into account the above-mentioned criticisms of due diligence and ensure strong compliance.

In an extensive survey of human rights due diligence legislation around the world, De Schutter and others have identified four main ways that such mechanisms have been established by states as regulatory measures. The first approach is to use due diligence as a ‘matter of regulatory compliance’.<sup>111</sup> In this case, conducting due diligence is a legal requirement. This can be done by directly imposing a rule mandating due diligence or by establishing due diligence as a legal defence for companies. The second approach is granting companies ‘incentives and benefits’ in return for conducting due diligence.<sup>112</sup> This means that companies demonstrating that they are acting with care could qualify for certain forms of state support or benefits. The third approach is ‘transparency and disclosure mechanisms’,<sup>113</sup> in which states legislate a requirement to disclose due diligence mechanisms as a way of putting social pressure on companies to create and carry out such processes. Finally, the fourth approach is combining the above-mentioned measures.<sup>114</sup> The survey

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109 Ibid, 233.

110 Brenkert (n 18) 305; Fasterling (n 106) 246.

111 Olivier De Schutter and others, ‘Human Rights Due Diligence: The Role of States’ (Report for the Human Rights Due Diligence Project, December 2012) 60.

112 Ibid.

113 Ibid.

114 Ibid.

identified the role of due diligence in regulation as a way to show what is expected from businesses and also to assist governments with gauging compliance.<sup>115</sup> De Schutter and others concluded that while several laws exist worldwide, countries could still ‘make far greater use of legal tools to ensure business due diligence for human rights’.<sup>116</sup>

In fact, legislating due diligence and related disclosure requirements have emerged as the main regulatory tools on business and human rights,<sup>117</sup> even if such efforts remain ‘patchy’.<sup>118</sup> As states are the sole duty-bearers and have an obligation to protect people against human rights violations, setting out clear legal expectations helps both governments and businesses fulfil their respective duties and responsibilities. The UN Working Group on the issue of human rights and transnational corporations and other business enterprises observed in 2018 that mandatory due diligence laws had already resulted in greater awareness of human rights responsibilities on top levels of business management and also increasingly through entire supply chains.<sup>119</sup>

Strengthening the position of human rights due diligence in international human rights law, the UN Committee on Economic, Social and Cultural Rights asserted in a 2017 general comment that in fact, States parties’ ‘obligation to protect entails a positive duty to adopt a legal framework requiring business entities to exercise human rights due diligence’.<sup>120</sup> This interpretation by the Committee builds on the notion that states are the ultimate duty-bearers in the international human rights system, and as such, one aspect of their duty to protect human rights is ensuring that mandatory human rights due diligence is carried out by companies under their jurisdiction. Additionally, the Committee noted that states can be held directly responsible for business-related human rights violations if the entity involved is (a) controlled by the state, (b) empowered by the state to exercise governmental authority or (c) if a state acknowledges its conduct as its own.<sup>121</sup> The Committee extended the requirement for due diligence to apply extraterritorially as well, stating, ‘Corporations domiciled in the territory and/or jurisdiction of States parties should be required to act with due diligence to identify, prevent and address abuses to Covenant rights by such subsidiaries and business partners, wherever they may be located.’<sup>122</sup> This strong position taken by

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115 Ibid, 59.

116 Ibid, 60.

117 Sandra Cossart, Jerome Chaplier and Tiphaine Beau De Lomenie, ‘The French Law on Duty of Care: A Historic Step Towards Making Globalization Work for All’ (2017) 2 Business and Human Rights Journal 317, 318.

118 Working Group on the Issue of Human Rights and Transnational Corporations and Other Business Enterprises, ‘The Report of the Working Group on the Issue of Human Rights and Transnational Corporations and Other Business Enterprises (16 July 2018) A/73/163, 10.

119 Ibid, 18.

120 Committee on Economic, Social and Cultural Rights, ‘General Comment No 24 (2017) on State Obligations under the International Covenant on Economic, Social and Cultural Rights in the Context of Business Activities’ (10 August 2017) E/C12/GC/24, 5.

121 Ibid, 4.

122 Ibid, 10-11.

the Committee – a relatively recent development – signals the way forward for mandatory human rights due diligence as a requirement for states to fulfil their treaty obligations.

## 1.8 The UNGPs and the European Union

The EU has been one of the earliest and most ardent supporters of the UNGPs. Just months after the principles had been approved by the UN Human Rights Council, the European Commission committed to their implementation in a communication outlining a new strategy on Corporate Social Responsibility for the 2011-2014 period.<sup>123</sup> The European Commission said that it expected European companies to abide by the UNGPs and called on EU countries to develop NAPs. In June 2012, EU member states also expressed their support for the implementation of the UNGPs, reaffirming the European Commission's direction on business and human rights.<sup>124</sup> The UNGPs have since become a fixture of the EU's human rights and democracy agenda and continues to be a crucial part of the 2015-2019 action plan on the issue applying both within the Union and in the EU's external policy.<sup>125</sup>

The past years saw a number of EU countries publish action plans, which process, as discussed above, has received mixed reactions. When looking at it at EU level, the NAPs have failed to foster the creation of a coherent European framework, which, Neglia noted, has been 'ultimately undermining the effectiveness of the entire process'.<sup>126</sup> With a patchwork of action plans that often don't live up to the ambitions of the UNGPs, it has become clear that there's a pressing need for EU-level coordination. In an opinion focusing specifically on the third pillar of the UNGPs, access to remedy, the European Union Agency for Fundamental Rights (FRA) noted that,

Given that the EU's role and competence on business and human rights is dispersed across a number of policy areas, a dedicated EU-level Action Plan, based on the same criteria as the national ones, could bundle envisaged activities over a certain timespan and render the EU's contribution more visible.<sup>127</sup>

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123 European Commission (n 49).

124 Council of the European Union, 'EU Strategic Framework and Action Plan on Human Rights and Democracy' (25 June 2012) 11855/12.

125 Council of the European Union, Foreign Affairs Council, 'Council Conclusions on the Action Plan on Human Rights and Democracy 2015-2019' (20 July 2015) 10897/15; Council of the European Union, Foreign Affairs Council, 'Council Conclusions on Business and Human Rights' (20 June 2016) 10254/16.

126 Maddalena Neglia, 'The UNGPs – Five Years On: From Consensus to Divergence in Public Regulation on Business and Human Rights' (2016) 34 *Netherlands Quarterly of Human Rights* 289, 303.

127 European Union Agency for Fundamental Rights, 'Improving Access to Remedy in the Area of Business and Human Rights at the EU Level, Opinion of the European Union Agency for Fundamental Rights' (10 April 2017) FRA Opinion 1/2017, 16.

Having such an EU-level plan would certainly signal that the Union throws its full weight behind the UNGPs and could also lead to the development of more ambitious plans than those of governments. To date, the European Commission has released a few staff working documents on the implementation of the EU's business and human rights agenda,<sup>128</sup> however, these have been for the most part mere overviews of the state of play, which is exactly what critics of the NAPs process have lamented.

At the same time, the EU could also act as a catalyst for the creation and implementation of individual NAPs. FRA advised the Union to 'encourage faster adoption, greater harmonisation, better comparison between the plans, and stronger peer review on the plans themselves and on the action to which they are committed' by utilising the Open Method of Coordination (OMC) approach.<sup>129</sup> The OMC, which is a soft-law instrument used to create cooperation frameworks to reach common objectives among governments,<sup>130</sup> could be used to identify and implement EU-wide approaches in areas falling outside the Union's competences.<sup>131</sup> It could be used to rectify some of the problems identified in the NAPs process by establishing common timetables, benchmarks and peer-review mechanisms under an EU umbrella.<sup>132</sup> While the OMC, by definition, would not produce any binding legislation, it could provide an effective platform for EU member states to start working towards largely uniform policies on implementing the UNGPs.<sup>133</sup>

While the UNGPs require domestic laws for their implementation for the most part, the EU has also passed binding measures in the area of business and human rights given its competences. The following major regulatory measures have been adopted by the EU to date:

- The EU Timber Regulation<sup>134</sup> (2010) requiring businesses to undertake due diligence to ensure that no illegally harvested timber is placed on the EU market.
- The revised Public Procurement Directives<sup>135</sup> (2014), which allow for using sustainability, and environmental and social impact as procurement criteria.

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128 European Commission, 'Commission Staff Working Document on Implementing the UN Guiding Principles on Business and Human Rights – State of Play' SWD (2015) 144 final; European Commission, 'Commission Staff Working Document, Corporate Social Responsibility, Responsible Business Conduct, and Business & Human Rights: Overview of Progress' SWD (2019) 143 final.

129 European Union Agency for Fundamental Rights (n 127) 66.

130 Eur-Lex, 'Open Method of Coordination' (date published not available) Glossary of Summaries <[eur-lex.europa.eu/summary/glossary/open\\_method\\_coordination.html](http://eur-lex.europa.eu/summary/glossary/open_method_coordination.html)> accessed 15 May 2019.

131 Daniel Augenstein, 'Negotiating the Hard/Soft Law Divide in Business and Human Rights: The Implementation of the UNGPs in the European Union' (2018) 9 *Global Policy* 254, 260.

132 Ibid.

133 Daniel Augenstein, Mark Dawson and Pierre Thielborger, 'The UNGPs in the European Union: The Open Coordination of Business and Human Rights?' (2018) 3 *Business and Human Rights Journal* 1, 22.

134 Regulation (EU) No 995/2010 of the European Parliament and of the Council of 20 October 2010 laying down the obligations of operators who place timber and timber products on the market [2010] OJ L 295/23.

135 Directive 2014/24/EU of the European Parliament and of the Council of 26 February 2014 on public procurement and repealing Directive 2004/18/EC [2014] OJ L 94/65.

- The Non-Financial Reporting Directive<sup>136</sup> (2014) mandating that companies above a certain size disclose information on due diligence procedures on their social, environmental and human rights impacts and how they fight corruption and bribery.
- The General Data Protection Regulation<sup>137</sup> (2016) that created new rules on how entities, including businesses, can collect, store and process personal data.
- The Revised Shareholder Directive<sup>138</sup> (2017) that aims to improve EU companies listed on stock exchanges by incentivising investors to consider responsible long-term strategies.
- The Conflict Minerals Regulation<sup>139</sup> (2017) that lays down supply chain due diligence obligations for importers of tin, tantalum, tungsten and gold to mitigate risks associated with conflict-affected mining areas.
- Additionally, the European Parliament and EU member states reached a political agreement in March 2019 towards legislation laying down new disclosure requirements regarding sustainable investments and sustainability risks.<sup>140</sup>

While each of these laws relates to certain distinct areas of business and human rights, the EU seems to be using due diligence as the main way of implementing the UNGPs through legislation.

## 1.9 Human Rights Due Diligence in the European Union

Because of its aims and structure, the EU is in many ways uniquely placed to be a fertile ground for the cultivation of due diligence requirements. For once, the EU is an economic cooperation whose aim is to create ever-greater cohesion for the functioning of its internal market and to make the EU competitive on the global markets. At the same time, the EU is also a political union, guided by considerations of its long-term impacts at home and abroad. Translating these into practical terms, Article 5 of the Treaty of the European Union (TEU) establishes limits on EU competences through the ‘principle of conferral’, which means that member states hand over some

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136 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 [2014] OJ L 330/1.

137 Regulation (EU) 2016/679 of the European Parliament and of the Council of 27 April 2016 on the protection of natural persons with regard to the processing of personal data and on the free movement of such data, and repealing Directive 95/46/EC [2016] OJ L 119/1.

138 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 [2017] OJ L 132/1.

139 Regulation (EU) 2017/821 of the European Parliament and of the Council of 17 May 2017 laying down supply chain due diligence obligations for Union importers of tin, tantalum and tungsten, their ores, and gold originating from conflict-affected and high-risk areas [2017] OJ L 130/1.

140 European Commission, ‘Capital Markets Union: Commission Welcomes Agreement on Sustainable Investment Disclosure Rules’ (7 March 2019) IP/19/1571.

of their decision-making power to the Union in order to achieve objectives set by the EU.<sup>141</sup> Article 5 of TEU also sets out the principles governing the use of competences: subsidiarity and proportionality.<sup>142</sup> The principle of subsidiarity means that when an area is not covered by the exclusive competence of the EU, it can act only if the given goal ‘cannot be sufficiently achieved’ by individual countries and can be ‘be better achieved at Union level’.<sup>143</sup> At the same time, the principle of proportionality requires that the EU cannot act in a way that goes beyond what is strictly needed to reach a certain outcome.<sup>144</sup>

To date, three pieces of EU legislation contain requirements related to due diligence: the 2010 Timber Regulation, the 2014 Non-Financial Reporting Directive and the 2017 Conflict Minerals Regulation. The two Regulations require companies to carry out due diligence processes, while the Non-Financial Reporting Directive mandates companies to disclose information about their human rights due diligence mechanisms. Looking at preparatory documents by the European Commission that predated the adoption of these three legislative acts shows that the EU arrived at such solutions taking its aims and structure into account. While later chapters of the present thesis will focus on the individual pieces of legislation more closely, some general patterns can be discovered that help shed light on the EU’s relationship to due diligence in general. In all three legislative proposals, economic and political considerations intertwined creating the need for action. In the case of the Timber Regulation, the European Commission noted that illegal logging damaged the environment, undermined the competitiveness of logging operations and often contributed to corruption and violence.<sup>145</sup> In case of the Non-Financial Reporting Directive, the Commission said that such legislation was necessary to create a level playing field by providing essential information to investors, while also ensuring better outcomes on the way companies manage social and environmental risks.<sup>146</sup> The Commission’s proposal for the Conflict Minerals Regulation noted EU goals and strategies on foreign policy, development, sustainability, law enforcement and corporate social responsibility as the underlying reasons.<sup>147</sup> This shows that the EU sees its business and human rights agenda as a political consideration rooted in the goal of upholding certain values,

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141 Consolidated version of the Treaty on European Union [2016] OJ C 202/13, art 5.

142 Ibid, art 5.2.

143 Ibid, art 5.3.

144 Ibid, art 5.4.

145 Commission of the European Communities, ‘Proposal for a Regulation of the European Parliament and of the Council Laying Down the Obligations of Operators who Place Timber and Timber Products on the Market’ COM (2008) 644/3, 10.

146 European Commission, ‘Proposal for a Directive of the European Parliament and of the Council Amending Council Directives 78/660/EEC and 83/349/EEC as Regards Disclosure of Non-Financial and Diversity Information by Certain Large Companies and Groups’ COM (2013) 207 final, 2.

147 European Commission, ‘Proposal for a Regulation of the European Parliament and of the Council Setting up a Union System for Supply Chain Due Diligence Self-Certification of Responsible Importers of Tin, Tantalum and Tungsten, their Ores, and Gold Originating in Conflict- Affected and High-Risk Areas’ COM (2014) 111 final, 3.



while it is also instrumental for ensuring competitiveness, sustainability and long-term profitability in the economy.

These considerations were present as the European Commission took the principles of subsidiarity and proportionality into account in its legislative proposals. In terms of subsidiarity, all three proposals mention harmonisation as an objective serving both member states (by giving them leverage and creating a level playing field) and affected companies (by creating clear and unified rules) – even though, it is important to mention that the Conflict Minerals Regulations falls exclusively in the EU’s competence,<sup>148</sup> so the question of subsidiarity did not need to be considered. In any case, EU-level action ensures a wide reach for the measures, often spilling over into extraterritorial applications. This means that any EU action on business and human rights will have wide-ranging implications.

At the same time, the proportionality principle is in many ways what led the EU to choose due diligence over other mechanisms to reach its stated objectives. This is very clearly demonstrated in the Commission’s proposal for the Timber Regulation. The Commission initially presented four options for tackling the issue of illegal logging ranging from completely voluntary measures to an outright ban on placing illegally harvested timber on the EU market.<sup>149</sup> However, public consultations showed that none of these options were acceptable: the voluntary measures would have been too lax, while a strict ban would have put an undue burden on companies and could have hurt the market.<sup>150</sup> Thus, a fifth option emerged: mandatory due diligence. The Commission explained that such a risk-based approach was the most proportional option to ensure that the trade of illegal timber is squashed, while at the same time the burden placed on companies is not so large that it could hurt their business.<sup>151</sup> Similar considerations were also made in the cases of the Non-Financial Reporting Directive and the Conflict Minerals Regulation. This shows that due diligence seems to be the middle ground that fits well into the EU’s proportionality framework.

Since these EU laws have come into effect, developments on the international and national levels have demonstrated that due diligence appears to be the way forward. The above-mentioned General Comment 24 by the UN Committee on Economic, Social and Cultural Rights, which was adopted after the EU had passed its currently existing legislation with due diligence provisions, signals a move by the international community towards making mandatory due diligence laws a state obligation for the protection of human rights.<sup>152</sup> When it comes to national legislation, in 2015, the United Kingdom passed the Modern Slavery Act, which requires companies to disclose the steps

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148 Ibid, 6.

149 COM (2008) 644/3 (n 145) 5-7.

150 Ibid.

151 Ibid, 11.

152 Committee on Economic, Social and Cultural Rights (n 120).

taken to prevent human trafficking and slavery in their supply chains.<sup>153</sup> In 2017, France adopted an ambitious law setting out the duty of vigilance (*devoir de vigilance*) for companies registered in France and employing at least 5,000 people.<sup>154</sup> The French law sets out not only due diligence obligations down the supply chains but also monitoring and follow-up requirements. These are then also tied to a civil liability regime.<sup>155</sup> The French law is considered to be a ‘milestone’ in the corporate social responsibility arena with many hoping that the EU as a whole will follow suit.<sup>156</sup>

Indeed, calls abound in the EU to establish mandatory supply chain due diligence. Marking the two-year anniversary of the tragic Rana Plaza accident in Bangladesh, the European Parliament urged the European Commission in 2015 to consider such measures noting, ‘new EU legislation is necessary to create a legal obligation of due diligence for EU companies’.<sup>157</sup> The European Parliament has since reiterated this request on multiple occasions,<sup>158</sup> including in a 2018 resolution that called for the introduction of ‘an overarching, mandatory due diligence framework including a duty of care to be fully phased-in within a transitional period’.<sup>159</sup> The European Commission responded to this request by commissioning a study to explore the possibility and feasibility of mandatory supply chain due diligence legislation.<sup>160</sup> The study is due to be published later in 2019. Thus, it seems that the EU is moving in the direction of mandatory due diligence that will likely have an impact on global supply chains.

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153 Modern Slavery Act 2015, sec 54(2)(b) (UK).

154 *loi* no 2017-399 du 27 Mars 2017 relative au devoir de vigilance des sociétés mères et des entreprises donneuses d’ordre (France).

155 *Ibid.*

156 Cossart and others (n 117) 323.

157 European Parliament resolution of 29 April 2015 on the second anniversary of the Rana Plaza building collapse and progress of the Bangladesh Sustainability Compact P8\_TA (2015) 0175, para 23.

158 See European Parliament resolution of 12 September 2017 on the impact of international trade and the EU’s trade policies on global value chains P8\_TA (2017) 0330, para 9.

159 European Parliament resolution of 29 May 2018 on sustainable finance P8\_TA (2018) 0215, para 6.

160 British Institute of International and Comparative Law, ‘European Commission Study on Human Rights Due Diligence in Supply Chains’ <[www.biiicl.org/bhr-eu](http://www.biiicl.org/bhr-eu)> accessed 20 May 2019; Business & Human Rights Resource Centre, ‘Call for Input: EU Commission Study on Regulatory Options for Mandatory Human Rights Due Diligence’ (29 March 2019) <[www.business-humanrights.org/en/call-for-input-eu-commission-study-on-regulatory-options-for-mandatory-human-rights-due-diligence](http://www.business-humanrights.org/en/call-for-input-eu-commission-study-on-regulatory-options-for-mandatory-human-rights-due-diligence)> accessed 22 May 2019.

## **Chapter 2: Mandatory Disclosures on Due Diligence – The Non-Financial Reporting Directive**

### **2.1 The Nature of Mandatory Transparency Measures**

Requiring companies to disclose non-financial information, including their human rights due diligence policies, is one way of incentivising businesses to design and carry out such duty of care processes. In this case, the legal requirement is for transparency, however, the underlying goal is for companies to show – through developing and implementing due diligence – that they actively work on taking social and environmental issues into consideration to avoid public backlash. The reporting requirement has a two-pronged approach: it mandates companies to provide information to regulators and stakeholders on possible risks, and it also prompts a commitment from companies to mitigate those risks.<sup>161</sup> Thus, the power of such legislation lies in its capacity to name and shame companies, and not in setting out precise requirements for how social and environmental factors should be taken into account.

Transparency requirements had existed before the UNGPs, mainly in the form of mandatory disclosures on Corporate Social Responsibility (CSR) policies.<sup>162</sup> However, CSR policies tend to have wider aims and means than the narrow focus of protecting human rights.<sup>163</sup> Thus, the specific focus on human rights and due diligence with regards to transparency have emerged largely from the UNGPs. In fact, Principle 21 of the UNGPs explicitly calls for transparency as part of the due diligence process aimed at informing various stakeholders, including investors.<sup>164</sup> Transparency laws have their power in opening companies up to public scrutiny, allowing consumers, investors and affected stakeholders to judge a company's actions based on social expectations. This could seriously impact businesses' bottom lines as revelations about socially unacceptable behaviours – which can range from being connected to certain political issues all the way to serious human rights abuses – have often led consumers to boycott certain brands and products.<sup>165</sup>

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161 Olivier De Schutter and others, 'Human Rights Due Diligence: The Role of States' (Report for the Human Rights Due Diligence Project, December 2012) 43.

162 Ibid, 44.

163 Anita Ramasastry, 'Corporate Social Responsibility Versus Business and Human Rights: Bridging the Gap Between Responsibility and Accountability' (2015) 14 *Journal of Human Rights* 237.

164 United Nations, 'Guiding Principles on Business and Human Rights: Implementing the United Nations "Protect, Respect and Remedy" Framework' (2011) (UNGP) HR/PUB/11/04, 23.

165 For a sample list of boycotted companies and reasons for the boycotts see Ethical Consumer, 'Boycotts List' <[www.ethicalconsumer.org/ethicalcampaigns/boycotts](http://www.ethicalconsumer.org/ethicalcampaigns/boycotts)> accessed 22 May 2019.

While increased transparency is an important goal for the UNGPs, it's not an end in and of itself: it is meant to ensure that companies act the right way and, if problems are identified, they change their behaviour. Thus, the question becomes to what extent reporting requirements can bring about organisational change. According to Buhmann, that depends on the communication being *ex-ante* or *ex-post*.<sup>166</sup> *Ex-ante* communication can occur as part of companies' due diligence processes aimed at prevention, which means that it factors into decision-making. *Ex-post* communication, which is what most mandatory reporting laws prescribe, shows companies' past actions, which, Buhmann argued, 'has little effect on organizational decision-making to reduce adverse impact on society'.<sup>167</sup> While public disclosure policies are important tools – even as companies can tailor reports to avoid public criticism – they seem to be less than enough to prompt organisational learning.

Another question is what is being disclosed. This means, first of all, whether the measure lays out specifically the type of information that companies have to report on. As companies tend to hold information on their operations close their chest for fear of losing some of their competitive edge, defining the type of details required is important. Of course, the consideration in allowing larger flexibility for companies is to minimise burdens and ensure that the reporting requirements don't put the company at a competitive disadvantage. However, this can lead to fragmentation, which can eventually defeat the purpose of mandatory disclosures.<sup>168</sup> Secondly, the quality and veracity of the information also matter. If a law merely requires certain disclosures without any follow-up mechanisms or external verification, the quality of the information might not be up to par. In fact, the reporting process might become a mere public relations exercise aimed at putting the company in the best light possible. As Buhmann noted about the EU's non-financial transparency measure, 'Sanctions are applied to non-disclosure, not accuracy.'<sup>169</sup> Thus, mandating reporting itself doesn't seem to guarantee quality information unless certain parameters and follow-up mechanisms are defined.

## 2.2 The EU's Non-Financial Reporting Directive

Transparency is an integral part of operating the EU's single market, which is built on maintaining fair competition. The European Commission first acknowledged the need for increased

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166 Karin Buhmann, 'Neglecting the Proactive Aspect of Human Rights Due Diligence? A Critical Appraisal of the EU's Non-Financial Reporting Directive as a Pillar One Avenue for Promoting Pillar Two Action' (2018) 3 Business and Human Rights 23, 35.

167 Ibid, 36.

168 Koen HM De Roo, 'The Role of the EU Directive on Non-Financial Disclosure in Human Rights Reporting' (2015) 12 European Company Law 278, 284.

169 Buhmann (n 166) 44.

transparency in the area of social and environmental impacts of businesses in order to create a level playing field in a 2011 communication,<sup>170</sup> and this notion was reaffirmed again in the Commission's 2011-2014 CSR strategy.<sup>171</sup> The Non-Financial Reporting Directive (NFR Directive)<sup>172</sup> was eventually adopted in 2014, amending the EU's 2013 Accounting Directive<sup>173</sup> to require mandatory disclosures of non-financial information. The latter legislation was aimed at simplifying accounting requirements for companies in the EU, while also ensuring that financial statements are transparent and easily comparable. The NFR Directive came in relatively quick succession adding reporting requirements with regards to companies' social and environmental impacts.

The aim of the Directive is the harmonisation of non-financial and diversity information throughout the EU with the long-term goal of ensuring sustainability and economic stability.<sup>174</sup> The immediate aims of the Directive are increased transparency and harmonisation of reporting requirements across the EU to 'enhance the consistency and comparability of non-financial information'.<sup>175</sup> Increased transparency on sustainability such as 'social and environmental factors' can help identify risks and increase trust in EU companies, according to the Directive.<sup>176</sup> In its proposal for the Directive, the European Commission explained that transparency was crucial for companies to better manage risks, for civil society to assess the impact companies' operations can have on them, and for investors to be able to make financially prudent investments.<sup>177</sup> At the same time, harmonisation of what information needs to be disclosed is needed to ensure fair competition across the EU.<sup>178</sup> The Directive further adds, 'Indeed, disclosure of non-financial information is vital for managing change towards a sustainable global economy by combining long-term profitability with social justice and environmental protection.'<sup>179</sup> Thus, the long-term aim is a combination of the EU's economic and political agendas.

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170 European Commission, 'Communication from the Commission to the European Parliament, the Council, the Economic and Social Committee and the Committee of the Regions: Single Market Act – Twelve Levers to Boost Growth and Strengthen Confidence' COM (2011) 206 final, 15.

171 European Commission, 'A Renewed EU Strategy 2011-14 for Corporate Social Responsibility' COM (2011) 681 final, 12.

172 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 (NFR Directive) [2014] OJ L 330/1.

173 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, amending Directive 2006/43/EC of the European Parliament and of the Council and repealing Council Directives 78/660/EEC and 83/349/EEC (Accounting Directive) [2013] OJ L 182/19.

174 NFR Directive, recitals 1-4.

175 Ibid, recital 5.

176 Ibid, recital 3.

177 European Commission, 'Proposal for a Directive of the European Parliament and of the Council Amending Council Directives 78/660/EEC and 83/349/EEC as Regards Disclosure of Non-Financial and Diversity Information by Certain Large Companies and Groups' COM (2013) 207 final, 2.

178 Ibid.

179 NFR Directive, recital 3.

The Directive applies to large EU undertakings that are public-interest entities with more than 500 employees.<sup>180</sup> The 2013 Accounting Directive defines public-interest entities as follows: (a) companies governed by the law of an EU country and whose transferable securities are admitted to trading on a regulated market of any member state, (b) credit institutions, (c) insurance undertakings, and (d) those designated as public-interest entities by EU governments.<sup>181</sup> Additionally, to qualify as a large undertaking, a company has to fulfil at least one of the following two requirements: (a) a balance sheet total of €20m or (b) a net turnover of over €40m.<sup>182</sup> The NFR Directive thus applies to a total of around 6,000 companies.<sup>183</sup> It is important to note here that this is a much smaller scope than contained in the original proposal. The European Commission wanted to include all EU companies with more than 500 employees, which would have affected 18,000 entities – and this was already a higher threshold than applied for mandatory financial disclosures (250 employees), which would have included 40,000 companies.<sup>184</sup> The Commission explained in its legislative proposal that the threshold of 500 employees was appropriate to ensure that smaller businesses were not burdened with undue administrative requirements, while for bigger companies, the disclosure requirements would be ‘commensurate to the value and usefulness of the information and the size, impact and complexity of the undertakings’.<sup>185</sup> While public documents on the negotiation process are hard to come by, some NGOs critically noted at the time the pressure from companies and governments, notably that of Germany, to weaken the proposed Directive’s provisions.<sup>186</sup> Thus, the fact that the Directive only applies to public-interest entities in the end most likely shows that lobbying by businesses throughout the legislative process led to the dramatic reduction in the already reduced scope of the Directive.

The Directive defines minimum standards for non-financial disclosures. Information must be included on companies’ processes related to environmental, social and labour issues, human rights, anti-corruption and bribery.<sup>187</sup> These must be communicated by including the following information:

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180 Ibid, art 1.1.

181 Accounting Directive, art 2.1.

182 Ibid, art 3.4. Note that the Accounting Directive includes a total of three criteria out of which a company has to fulfil at least two to qualify as a large undertaking, however, one of those is having more than 250 employees. As the NFR Directive applies only to companies with at least 500 employees, that criterion can be considered fulfilled.

183 European Commission, ‘Disclosure of Non-Financial and Diversity Information by Large Companies and Groups – Frequently Asked Questions’ (15 April 2014) MEMO 14/301.

184 European Commission, ‘Disclosure of Non-Financial and Diversity Information by Certain Large Companies and Groups (Proposal to Amend Accounting Directives) - Frequently Asked Questions’ (16 April 2013) MEMO 13/336.

185 COM (2013) 207 (n 177) 7.

186 Kim Bizzarri, ‘Refusing to Be Accountable: Business Hollows out New EU Corporate Social Responsibility Rules’ (Corporate Europe Observatory, April 2013)

<[https://en.frankbold.org/sites/default/files/tema/refusing\\_to\\_be\\_accountable.pdf](https://en.frankbold.org/sites/default/files/tema/refusing_to_be_accountable.pdf)> accessed 25 June 2019.

187 NFR Directive, art 1.1.

- (a) a brief description of the undertaking's business model;
- (b) a description of the policies pursued by the undertaking in relation to those matters, including due diligence processes implemented;
- (c) the outcome of those policies;
- (d) the principal risks related to those matters linked to the undertaking's operations including, where relevant and proportionate, its business relationships, products or services which are likely to cause adverse impacts in those areas, and how the undertaking manages those risks;
- (e) non-financial key performance indicators relevant to the particular business.<sup>188</sup>

Thus, the Directive specifies that information on due diligence mechanisms must be part of non-financial disclosures. The legislation also lays down the conditions for non-reporting: first, member states can allow companies not to disclose information if it is deemed to be 'seriously prejudicial to the commercial position of the undertaking',<sup>189</sup> in other words, if it were to damage fair competition. Second, when businesses don't have specific policies on the above-mentioned issues, their non-financial statement must provide a 'clear and reasoned explanation'<sup>190</sup> for why that is the case. This is basically the 'comply or explain' principle that has long been used in various national business-related legislation throughout Europe, including in Germany and the UK. Under this principle, non-compulsory measures (such as codes of conduct or recommendations) are combined with mandatory reporting requirements: companies either have to state that they comply with the non-compulsory measures, or state that they don't and explain why not.<sup>191</sup> The aim of the principle is to increase transparency and allow shareholders to better evaluate company policies.<sup>192</sup>

In terms of compliance, the Directive requires EU member states to ensure that auditors check that companies have indeed provided non-financial statements.<sup>193</sup> However, as to the content of the disclosures, it is up to each individual government to decide whether to require independent verification.<sup>194</sup> This shows that the EU aimed at setting minimum standards. In line with the Directive, the Commission also published a set of non-binding guidelines to help companies provide relevant non-financial statements, however, the document serves mainly as a signpost

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188 Ibid.

189 Ibid.

190 Ibid, art 1.3.

191 Christian Andres and Erik Theissen, 'Setting a Fox to Keep the Geese – Does the Comply-or-Explain Principle Work?' (2008) 14 *Journal of Corporate Finance* 289.

192 Andrew Keay, 'Comply or Explain in Corporate Governance Codes: In Need of Greater Regulatory Oversight?' (2014) 34 *Legal Studies* 279.

193 NFR Directive, art 1.3.

194 Ibid.

explaining some best practices.<sup>195</sup> The Directive further acknowledges that companies can utilise a number of existing national, EU-level or international frameworks for their reporting, later listing many of them in the communication on non-binding guidelines as the basis of the Commission's recommendations.<sup>196</sup> As the Commission noted, companies should make full use of the flexibility provided in the Directive, adding, 'The guidelines are not intended to stifle innovation in reporting practices.'<sup>197</sup>

The deadline for transposing the Directive into national law was 6 December 2016, and the reporting requirements first applied for the financial year starting in 2017.<sup>198</sup> The Commission was tasked with submitting a report on the implementation and effectiveness of the Directive by 6 December 2018, including possible legislative proposals to amend the Directive as needed.<sup>199</sup> As of June 2019, the Commission has not published such a review. In March 2018, the Commission did release an action plan on sustainable growth, urging increased transparency and calling for the inclusion of climate-related information under the NFR Directive.<sup>200</sup> To this end, the Commission published in June 2019 a supplement to its 2017 non-binding guidelines with guidance on reporting climate-related information.<sup>201</sup> The 2018 action plan also acknowledged that the Directive was in need of revisions, noting that 'Going forward, an appropriate balance needs to be struck between flexibility and the standardisation of disclosure necessary to generate the data needed for investment decisions.'<sup>202</sup>

Given that the Commission hasn't published its report yet, the impact of the enhanced reporting requirements has yet to be seen. However, there seem to be indications that there's a long way ahead to reach the desired outcome of increased transparency. First of all, this has to do with the wording of the Directive and the accompanying guidance by the European Commission. The Directive, in the spirit of ensuring flexibility, merely states that companies should provide descriptions of their policies, 'including due diligence processes implemented' related to issues covered under non-financial reporting such as social, environmental, labour and human rights issues.<sup>203</sup> The Directive does not provide any more guidance on what disclosures on due diligence mechanisms should look like. The Commission guidelines expand a bit more on the notion of due

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195 European Commission Communication C/2017/4234 Guidelines on non-financial reporting (methodology for reporting non-financial information) (NFR Guidelines) [2017] OJ C 215/1.

196 Ibid, 3.

197 Ibid.

198 NFR Directive, art 4.

199 Ibid, art 3.

200 European Commission, 'Communication from the Commission – Action Plan: Financing Sustainable Growth' COM (2018) 97 final.

201 Communication from the Commission C/2019/4490 Guidelines on non-financial reporting: Supplement on reporting climate-related information [2019] OJ C 209/1.

202 COM (2018) 97 (n 200) 10.

203 NFR Directive, art 1.1.



diligence noting that ‘They help identify, prevent and mitigate existing and potential adverse impacts.’<sup>204</sup> The guidelines further specify that ‘where relevant and appropriate’, companies should also disclose information on their supply chain due diligence,<sup>205</sup> however, such wording of an already non-binding guidance makes it very unlikely that such reporting would take place (unless companies already routinely implement and report on these processes). For further information on due diligence, the guidance refers to the UNGPs and related non-binding documents, which, as previously discussed, are also rather vague in terms of setting up frameworks on due diligence. Thus, besides giving a few examples of what could be considered part of the disclosure on due diligence, the guidance doesn’t provide much further information.

A 2017 survey on the transposition of the Directive showed that EU countries used the flexibility provided to define the scope of companies included and to establish penalties for non-compliance.<sup>206</sup> In fact, most countries expanded the scope of companies required to submit non-financial information, and all but three countries specified penalties for failure to comply.<sup>207</sup> At the same time, the EU member states mostly stuck to the Directive’s scope and wording on the reporting requirements and frameworks. It seems that for the most part, countries replicated the Directive’s approach of defining minimum standards for non-financial reporting as opposed to laying down more stringent requirements for what needed to be disclosed. However, the fact that countries did go beyond the Directive in terms of the scope of companies covered and penalties does signal some political will to strengthen the legislation.

Most EU member states also decided against further specifying due diligence reporting requirements when they transposed the Directive into their national laws. According to a study of how Germany, the UK, France and Italy – the EU’s four largest economies – transposed the EU legislation, ‘the wording from the Directive on policies and due diligence has generally been replicated in the implementing legislation (without providing any further detail on the types of policies that may be reported on, or how their outcomes could be measured)’.<sup>208</sup> Additionally, another study assessing the quality of non-financial statements issued by more than 100 companies found that the number of disclosures on human rights due diligence policies specifically was rather low: only 36% of companies surveyed described their human rights due diligence processes, and

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204 NFR Guidelines, 11.

205 Ibid.

206 GRI and CSR Europe, ‘Member State Implementation of Directive 2014/95/EU: A Comprehensive Overview of how Member States are Implementing the EU Directive on Non-financial and Diversity Information’ (2017) <[https://globalreporting.org/resourcelibrary/NFRpublication%20online\\_version.pdf](https://globalreporting.org/resourcelibrary/NFRpublication%20online_version.pdf)> accessed 28 May 2019.

207 Ibid, 10.

208 Claire Jeffery, ‘Comparing the Implementation of the EU Non-Financial Reporting Directive in the UK, Germany, France and Italy’ (Frank Bold, November 2017) 5 <[http://en.frankbold.org/sites/default/files/tema/comparing\\_the\\_eu\\_non-financial\\_reporting\\_directive\\_annexes.pdf](http://en.frankbold.org/sites/default/files/tema/comparing_the_eu_non-financial_reporting_directive_annexes.pdf)> accessed 27 May 2019.

even fewer, 26% of the companies, provided clear descriptions of salient human rights issues.<sup>209</sup> This shows that the Directive's flexible approach to reporting requirements on due diligence processes doesn't seem to be producing the desired outcomes in terms of increased transparency and harmonisation.

### **2.3 A Case Study of Non-Financial Reporting by Banks**

The Directive is the first EU legislation calling for mandatory disclosure on the human rights due diligence processes companies undertake. This is in line with the Directive's main aim of ensuring increased transparency and ultimately, better financial decision-making. Of course, on the flip side, greater scrutiny from regulators, consumers and investors means increased pressure to implement due diligence processes and show that companies are conscious of non-financial risks factors involved in their activities. Thus the question – which falls outside the aims of the Directive, yet is important from a human rights perspective – is whether enhanced reporting requirements lead to better due diligence processes and outcomes. It is impossible to give a definitive answer to this given that the NFR Directive has not been in force for too long, nor has there been an overarching review of its effects.

As discussed above, *ex-post* reporting requirements rarely contribute to organisational learning,<sup>210</sup> however, reporting requirements do send a signal to companies on what basic considerations they need to take into account in order to satisfy regulatory measures. At the same time, growing societal pressure for greater transparency and better management of environmental and social risks can also result in voluntary disclosures and better policies. One of the EU's aims with the NFR Directive was to ensure more sustainable and prudent investment, which means that the disclosure measures are meant to make sure that companies both show due diligence and also act in accordance with the stated policies. Thus, the disclosure requirements would logically lead to better processes and outcomes than mere voluntary reporting carried out by companies.

To investigate the practical implementation of the Directive, the following brief case study will compare human rights due diligence processes described by a company under the scope of the NFR Directive, namely Deutsche Bank, and a company that does not fall under the same non-financial reporting requirements, Bank of America. The analysis seeks to compare developments in the EU and the United States on how companies regard human rights due diligence and how they disclose information on such processes, even as they operate in different legal environments. The

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209 Alliance for Corporate Transparency, '2018 Research Report' (Alliance for Corporate Transparency Project 2019) 43-44.

210 See Buhmann (n 166).

analysis builds on publicly-available documents found on the two banks' websites and zeroes in on due diligence processes described related to human rights. While it is possible that both companies have much more extensive due diligence policies in place, whose descriptions are only available internally, the present study aims to show how the two companies chose to communicate human rights due diligence processes in light of different reporting requirements and compare the processes described.

Deutsche Bank's 2018 Annual Non-Financial Report<sup>211</sup> conforms to the new EU requirements and contains much relevant information. It identifies due diligence on environmental and social factors as an important aspect of decision-making processes. Such due diligence is a key component of the company's risk management framework, the bank notes. Besides outlining general due diligence processes, the report also lists eight sectors where the bank exercises heightened vigilance, including activities with 'potential for human rights' infringements'.<sup>212</sup> In terms of human rights, Deutsche Bank notes that its 'objective is not to engage in any activities or relationships where there is clear evidence of severe human rights' violations'.<sup>213</sup> The report further expands on the bank's activities to screen client transactions and review vendors to avoid human rights violations.

Bank of America's 2018 Annual Report<sup>214</sup> contains almost no information on its human rights due diligence policies. It does mention the bank's increased focus on environmental, social and governance (ESG) policies, noting that they are taken into account to 'manage risk associated with addressing the world's biggest environmental and social issues'.<sup>215</sup> However, the report seems to portray the bank's activities connected to ESG as voluntary measures that are done out of business considerations and the desire to bring about a better world. The notion of human rights responsibilities and related due diligence processes are not present at all. Bank of America does publish annual reports dedicated to its ESG track-record,<sup>216</sup> whose latest edition seems to focus on the positive achievements of the bank's policies in 2018, including how they helped communities and fostered investment in renewable energy. However, as expected, Bank of America's annual report does not include much of the kind of non-financial information that is mandated by the EU Directive.

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211 Deutsche Bank, 'Non-Financial Report 2018' (22 March 2019)

<[https://db.com/ir/en/download/Deutsche\\_Bank\\_Non-Financial\\_Report\\_2018.pdf](https://db.com/ir/en/download/Deutsche_Bank_Non-Financial_Report_2018.pdf)> accessed 28 May 2019.

212 Ibid, 29.

213 Ibid, 41.

214 Bank of America, '2018 Annual Report' (date published not available)

<[http://media.corporate-ir.net/media\\_files/IROL/71/71595/BOAML\\_AR2018.pdf](http://media.corporate-ir.net/media_files/IROL/71/71595/BOAML_AR2018.pdf)> accessed 28 May 2019.

215 Ibid, 22.

216 Bank of America, 'The Power to Make a Difference: Environmental, Social and Governance' (2018 ESG Highlights report, date published not available) <<https://about.bankofamerica.com/assets/pdf/esg-2018-highlights.pdf>> accessed 29 May 2019.

Given, of course, that Bank of America was not required to publish a statement on its non-financial information, looking at the related policy frameworks published by the two companies might give a fuller and more nuanced picture of their due diligence policies. Deutsche Bank's Environmental and Social Policy Framework outlines the main steps of its social and environmental due diligence process as follows: (1) risk identification, (2) risk assessment, (3) decision-making and (4) post-transaction follow-up.<sup>217</sup> When it comes to human rights, in particular, the bank says it has integrated a 'wide range of international standards and principles including the UN Guiding Principles on Business and Human Rights' into its due diligence processes.<sup>218</sup> The bank specifies that activities or clients that use child or forced labour are strictly banned from receiving financing.<sup>219</sup> Deutsche Bank also expects its clients to have adequate systems in place to avoid human rights violations. These include policies meant to protect affected communities from health and safety hazards, ensure respect for land rights and provide a platform for communities to voice concerns.<sup>220</sup> Similarly to its Non-Financial Report, Deutsche Bank identifies eight sectors with salient risks, including sectors with possible human rights violations, however, the Framework does not elaborate on that point<sup>221</sup>.

Surprisingly, Bank of America's Environmental and Social Risk Policy Framework provides a similarly thorough overview of the bank's ESG due diligence processes.<sup>222</sup> As in the case of Deutsche Bank, Bank of America's ESG due diligence is managed mainly under its reputational risk framework, even as the bank recognises the overarching nature of such risks requiring 'coordinated governance'.<sup>223</sup> Bank of America describes a standard due diligence process for clients with low levels of environmental and social risks. This process entails 'client engagement, media searches and other screening tools'.<sup>224</sup> If this process is not sufficient to adequately gauge the ESG risk factors – or the client or transaction is seen as high risk – an enhanced due diligence process is carried out by experts.<sup>225</sup> Such enhanced due diligence is implemented any time a transaction is deemed to have human rights implications.<sup>226</sup> In terms of human rights standards, Bank of America notes that it is committed to conducting its business in line with the 'United Nations Universal

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217 Deutsche Bank, 'Environmental and Social Policy Framework' (May 2018) <<https://db.com/cr/en/docs/DB-ES-Policy-Framework-English.pdf>> accessed 29 May 2019.

218 Ibid, 5.

219 Ibid, 4.

220 Ibid, 5.

221 Ibid, 3.

222 Bank of America, 'Bank of America Corporation Environmental and Social Risk Policy' (April 2019) <<https://about.bankofamerica.com/assets/pdf/Environmental-and-Social-Risk-Policy-Framework.pdf>> accessed 29 May 2019.

223 Ibid, 5.

224 Ibid, 8.

225 Ibid.

226 Ibid, 18.

Declaration of Human Rights<sup>227</sup> and the UNGPs, among others. The bank states that it does not engage in activities connected to child labour, forced labour or human trafficking, besides other activities that can lead to environmental damage or involve illegal financial transactions.<sup>228</sup> Bank of America also identifies eight sectors and several sub-sectors with heightened environmental and social risks where enhanced due diligence needs to be exercised. Most of them are the same as Deutsche Bank's, however, Bank of America also includes certain financial services, such as predatory lending, and the financing of private prisons as transactions with salient risks.<sup>229</sup> This shows that Bank of America is very much in line – at least on paper – with the due diligence processes described by the UNGPs.

As this brief analysis shows, while an initial look at the two companies' annual reports shows significant differences in the depth and quality of non-financial information disclosed, Deutsche Bank's policies are not at all superior to Bank of America's based on the frameworks described elsewhere. It is impossible to draw wide-ranging conclusions from this limited study, it is clear, however, that the nature and quality of due diligence processes described are not dependent on having reporting requirements. This is most likely connected to companies handling human rights risks first and foremost as part of reputational risk management. In some ways, the NFR Directive's mandate to disclose non-financial information is also aimed at demonstrating that companies are actively involved in managing risks. As such, it seems that the actual mitigation of human rights risks is a possible side-effect of the Directive, but not necessarily the main aim of it. It is important to note, finally, that despite the detailed information provided by the banks on the due diligence processes themselves, there is no independent verification that these mechanisms have produced the intended outcomes.

The EU's NFR Directive has been a decisive first step towards increased transparency and greater awareness to non-financial factors involved in business. However, the risk is that it will remain just that, a first step, unless there's political will on all levels to define reporting requirements and expand the list of companies mandated to disclose information.

To strengthen the Directive, the EU should move towards a more clearly-defined framework on reporting requirements to raise the quality of information gathered through the process. This point is not lost on the European Commission, which is in the process of carrying out an evaluation of the Directive, according to a European Commission official, who spoke on the condition of anonymity.<sup>230</sup> 'Not explaining in so much detail what is in fact required from companies hasn't

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227 United Nations, 'Universal Declaration of Human Rights' (10 December 1948) A/RES/217(III).

228 Bank of America (n 222) 9.

229 Ibid, 13-18.

230 Phone Interview with European Commission Official Working on the NFR Directive (conducted on the condition of anonymity) (Poznan, Poland, 6 June 2019).

helped in how disclosures have been this year and last year,' the official said. This has led to low comparability of non-financial information, essentially taking away the incentive for companies to improve the quality of the disclosed information and eventually, their processes. The official also noted that disclosures haven't been comprehensive and also tended not to go into detail in terms of outcomes. The level of reporting on human rights due diligence processes was the lowest, the official said, possibly because of the complexities and heightened sensitivities involved. Thus, there is indeed a push to revise the Directive to include more standardised requirements. However, the wording of the new requirements will still need to be flexible enough to avoid oversimplification, which could have a negative impact on both companies and investors.

As the Directive's main aim is to ensure the competitiveness of European companies, it remains to be seen to what extent the reporting requirements translate into more prudent investment decisions. As the above case study shows, having increased reporting requirements does not necessarily lead to better due diligence processes. Additionally, given that there's no mechanism to check the quality and veracity of the information provided under the Directive, it is also questionable whether mandatory disclosures will lead to better outcomes on the ground. Eventually, time will come when the EU must be willing to hold itself to its values and make bold political choices that show deference to human rights over profits and even competitiveness.

# Chapter 3: Legislating Mandatory Due Diligence – The Timber Regulation

## 3.1 The Nature of Imposing Mandatory Due Diligence

Laying down direct requirements for companies to carry out due diligence is another way to incorporate the concept into legislation. When states (or in the case that follows, the EU) mandate that companies carry out due diligence, the aim is to deal with a given violation through reducing the risk of it happening, while at the same time minimising the burden on businesses. This approach is a step up from complete corporate self-regulation, yet it still provides a lot of flexibility to ensure competitiveness. Such a risk-based approach acknowledges the complexity of corporate decision-making and global supply chains.

In the case of such legislation, businesses have to show that they have indeed engaged in due diligence or face a penalty for non-compliance. The fines are usually administrative for failing to comply with the regulation, however, in some cases, they can also be linked to civil and criminal sanctions, thus creating a strong incentive for compliance.<sup>231</sup> Authorities usually ensure compliance with such laws through mandatory reporting or periodic checks. Companies have to show not only that they have due diligence procedures in place but also that those mechanisms work as intended. Thus, legislating such requirements aim to make businesses act with care and minimise the chances of harmful events happening.

## 3.2 Illegal Logging: A Problem in Need of an Innovative Solution

Illegal logging has long been considered a pressing international problem with multifaceted negative implications. Illegal logging has an enormous environmental impact as trees are instrumental for taking carbon dioxide out of the atmosphere and halting soil degradation. Additionally, the World Wildlife Fund estimates that 80% of the world's terrestrial plants and animal species live in forests.<sup>232</sup> Thus, preserving forests is essential for ensuring biodiversity and fighting climate change. Illegal logging also has far-reaching human rights implications: local people (especially indigenous populations) can lose their livelihoods and be subjected to violence

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231 Olivier De Schutter and others, 'Human Rights Due Diligence: The Role of States' (Report for the Human Rights Due Diligence Project, December 2012) 19.

232 World Wildlife Fund, 'Stop Illegal Logging' (date published not available)  
<<https://worldwildlife.org/initiatives/stopping-illegal-logging>> accessed 27 June 2019.

when trying to defend their land.<sup>233</sup> People are often forced to migrate in search of better economic opportunities or are coerced into forced labour as the result of illegal logging.<sup>234</sup> Illegal harvesting of timber also takes a financial toll on affected countries, many of which are still considered developing. According to a 2014 estimate by the UN Environment Programme, illegal logging is worth \$30-100b each year.<sup>235</sup> This translates into revenues snatched up by criminal networks and lost taxes that could have been used to assist communities. Illegal logging can be very widespread: in Peru, about 80% of timber is harvested illegally, while the figure stands at 85% for Myanmar and 65% for the Democratic Republic of the Congo.<sup>236</sup>

The EU first took up the issue in the early 2000s, adopting an action plan in 2003 to combat the phenomenon.<sup>237</sup> In that action plan, the EU defined illegal logging as ‘timber [being] harvested in violation of national laws’, giving a few examples of the most dire consequences.<sup>238</sup> The use of such a loose definition shows the far-reaching and complex nature of the problem, especially considering that the United Nations Food and Agriculture Organization (FAO) decided that very same year just to begin the process of providing a precise and encompassing definition for illegal logging.<sup>239</sup> For the EU, illegal logging was identified as a global problem that undermined not only environmental protection but also many of the Union’s development objectives, such as poverty alleviation, the promotion of peace and security, fighting corruption, and ensuring sustainable development.<sup>240</sup>

The EU’s 2003 Forest Law Enforcement, Governance and Trade (FLEGT) Action Plan laid out various voluntary measures for governments and businesses to prohibit illegally harvested timber from entering the EU market. The plan centred around the development of a licensing scheme requiring timber-exporting countries that were willing to enter into Voluntary Partnership Agreements with the EU to make sure that only timber harvested in accordance with their national laws would get an export permit. Without the permit, the EU would not place timber from the exporting country on its market.<sup>241</sup> However, the plan didn’t prove overly successful, given that by

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233 Ibid.

234 Fernando Reboledo, ‘Socio-Economic, Environmental, and Governance Impacts of Illegal Logging’ (2013) 33 *Environ Syst Decis* 295.

235 UN Environment Programme, ‘Illegal Trade in Wildlife and Timber Products Finances Criminal and Militia Groups, Threatening Security and Sustainable Development’ (24 June 2014) <<https://unenvironment.org/news-and-stories/press-release/illegal-trade-wildlife-and-timber-products-finances-criminal-and>> accessed 27 June 2019.

236 World Wildlife Fund (n 232).

237 Commission of the European Communities, ‘Communication from the Commission to the Council and the European Parliament: Forest Law Enforcement, Governance and Trade (FLEGT)’ COM (2003) 251 final.

238 Ibid, 4.

239 FAO Advisory Committee on Paper and Wood Products, ‘Proceedings, Item 6a: Defining Illegal Logging: What Is It and What Is Being Done About It?’ (Forty-fourth Session, 8-9 May 2003) <[http://fao.org/3/Y4829E/y4829e07.htm#P3112\\_229918](http://fao.org/3/Y4829E/y4829e07.htm#P3112_229918)> accessed 4 June 2019.

240 COM (2003) 251 (n 237) 4.

241 Ibid, 12.



2008 only four countries had begun participating in the process.<sup>242</sup> This led the EU to begin consultations about new measures to stop illegal logging.

In a 2008 impact assessment, the European Commission defined illegal logging in a more comprehensive way to include ‘the harvest, transportation, purchase or sale of timber in violation of national laws’.<sup>243</sup> The Commission warned that illegal logging had a profound negative impact on the environment and also undermined competition, costing timber-producing countries €10-15b in lost revenues annually.<sup>244</sup> Additionally, the Commission noted that such activities were linked to corruption and organized crime, often fuelling violent conflicts, while also involving serious abuses of human rights.<sup>245</sup> Such abuses disproportionately affect local and indigenous communities. It was in this context that a legislative proposal was made to take concerted action throughout the EU.

The options proposed in the impact assessment were the following: (1) expanding the existing FLEGT voluntary partnership programme to include six major timber-exporting countries, (2) further developing voluntary measures to be taken up by the private sector, such as codes of conduct and certification schemes, (3) trying to stop illegally harvested timber at EU borders through compliance checks before those products can enter the EU market, (4) an outright prohibition on placing illegally harvested timber on the EU market through two possible approaches – (a) legislation banning the trade and possession of illegally logged wood or (b) legislation allowing only legally harvested timber to reach the EU market.<sup>246</sup> The assessment showed that Option 1 (expanding existing FLEGT partnership programme) was highly dependent on the voluntary participation in the licensing scheme of certain timber-exporting countries (some of which had previously stated their outright opposition to such partnerships), thus it was unlikely to be successful.<sup>247</sup> Option 2 (further voluntary measures for the industry) was overly reliant on voluntary self-regulation by the business sector, leaving little power for the EU for direct action.<sup>248</sup> Option 3 (compliance checks at EU borders) was deemed insufficient because it would have most likely not eliminated illegal timber harvest in countries of origin, rather, those exports would have been diverted to other markets in the world.<sup>249</sup> Additionally, questions over compliance with rules

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242 European Commission, ‘Commission Staff Working Document, Accompanying Document to the Proposal for a Regulation of the European Parliament and of the Council Determining the Obligations of Operators who Make Timber and Timber Products Available on the Market, Impact Assessment: Report on Additional Options to Combat Illegal Logging’ (date published not available, document identifying number not available), 16 <[http://ec.europa.eu/environment/forests/pdf/impact\\_assessment.pdf](http://ec.europa.eu/environment/forests/pdf/impact_assessment.pdf)> accessed 4 June 2019.

243 Ibid, 11.

244 Ibid.

245 Ibid.

246 Ibid, 19-21.

247 Ibid, 30.

248 Ibid, 31.

249 Ibid, 33.

under the World Trade Organization arose in the case of this scenario.<sup>250</sup> Option 4(a) (banning the trade and possession of illegal timber) would have largely eliminated illegal wood products from the EU market, yet, similarly to Option 3, it would have likely had little impact on illegal production in countries of origin.<sup>251</sup> Additionally, in this scenario, criminal investigations would have been needed to enforce the legislation, which the European Commission warned may have turned out to be costly yet still ineffective.<sup>252</sup> Finally, Option 4(b) (allowing only legally harvested timber to reach the EU market) was also deemed to be overly reliant on authorities' capacity to enforce such measures.<sup>253</sup> At the same time, stakeholders felt it was also inappropriate that such legislation would have significantly shifted the burden of proof by necessitating companies to show that timber was in fact legally harvested.<sup>254</sup> Thus, the European Commission began considering an alternative option that would combine the benefits of the most effective proposals, while at the same time also eliminating some of the drawbacks. It is commendable that the EU was so responsive to the outcome of the public consultations and chose to pursue options off the beaten track.

### **3.3 The Middle Road: Due Diligence**

The fifth option that emerged after the consultation process was the use of due diligence. Interestingly, the European Commission came up with this proposal as the work to develop the UNGPs (which include the use of due diligence to operationalise the principle of corporate responsibility to respect human rights) was still underway. Similarly to Ruggie's process, through which he sought the support of the private sector while also aiming for strong measures to ensure respect for human rights, the European Commission came up with the idea of using due diligence by combining the flexibility of Option 2 (self-regulation for businesses) with the legal certainty of Options 4(a) and (b) (banning illegal timber products from the EU market).<sup>255</sup> Instead of an outright ban, the Commission decided to try to minimise the risk of illegally harvested timber being sold in the EU through deterring businesses from selling products without assurances that they were legal. The Commission theorised that this would not only prevent illegal timber products from entering the EU market but would also have an impact on the behaviour of loggers and suppliers in the countries of origin.<sup>256</sup> In its explanation of the legislative proposal, the European Commission

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250 Ibid, 35.

251 Ibid, 36.

252 Ibid, 37.

253 Ibid, 40.

254 Ibid.

255 Ibid, 47.

256 Commission of the European Communities, 'Proposal for a Regulation of the European Parliament and of the Council Laying Down the Obligations of Operators who Place Timber and Timber Products on the Market' COM (2008) 644/3.

clarified that due diligence was ‘not just a moral duty to care but a legal requirement for a proactive behavior’, further adding, ‘It obliges operators to show prudence, judgment and positive action in ascertaining the legality of the timber and timber products that enter their supply chain in order to minimize the risk of placing illegally harvested timber and timber products on the Community market.’<sup>257</sup>

The Timber Regulation<sup>258</sup> was eventually adopted in 2010. It entered into force in 2013, becoming the first EU legislation encapsulating the principle of due diligence. The preamble of the Regulation lays out the main reasons for the measure: the illegal harvest of timber is ‘a pervasive problem of major international concern’ that threatens first and foremost the environment, yet also has negative implications for social, political and economic development and well-being.<sup>259</sup> Recognising that there is still no internationally-accepted definition for illegal logging, the Regulation defines such activities as being in violation of national laws applicable in the country of origin.<sup>260</sup> These are then clarified to include ‘applicable legislation’ related to certain aspects of timber harvesting and trade.<sup>261</sup> This shows that while the main aim of the legislation is environmental protection through decreasing demand for illegally harvested timber, the Regulation is also conscious of the various other problems connected to the phenomenon and the fact that these may vary depending on the context. Thus, the problem itself was so wide-ranging that it required a flexible but effective solution.

It is important to note that the Regulation doesn’t mention human rights specifically. The purpose of due diligence is to ensure that no illegally harvested timber enters the EU market, only one aspect of which could be if logging activity in the country of origin was connected to human rights violations. However, as the Timber Regulation requires operators to ensure that wood is logged in accordance with applicable national laws in the country of harvest, the legislation does not specifically require that human rights are upheld unless they are enshrined in local laws. The standard is not the EU’s level of human rights protection but rather that of the exporting country. Additionally, operators need to take into account the ‘prevalence of armed conflict’ in the country of origin and any ‘sanctions imposed by the UN Security Council or the Council of the European Union on timber exports and imports’.<sup>262</sup> Human rights violations might play an important role in these two cases, however, the wording is still too general to impose strict guidelines on taking

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257 Ibid, 9.

258 Regulation (EU) No 995/2010 of the European Parliament and of the Council of 20 October 2010 laying down the obligations of operators who place timber and timber products on the market (Timber Regulation) [2010] OJ L 295/23.

259 Ibid, recital 3.

260 Ibid, recital 14.

261 Ibid, art 2(h).

262 Ibid, art 6.1(b).

human rights risks into account. As such, while the Regulation does include human rights considerations in general, it doesn't require human rights due diligence *per se*.

Recognising that flexibility and the minimisation of administrative burdens are essential when regulating business operations, the Regulation differentiates between obligations for operators and traders. Operators, who place timber products on the market, are required to comply with a prohibition on illegally harvested wood products on the EU market and need to exercise due diligence.<sup>263</sup> Traders, who buy or sell timber products already on the EU market, are required to ensure traceability of those products.<sup>264</sup> Thus, the main burden to minimise the risk of illegally logged timber being placed on the EU market falls on the operators, who must take 'appropriate steps' to that end through the use of due diligence.<sup>265</sup>

The Regulation, for the first time in EU legislation, lays out the essential components of due diligence: (1) access to information, (2) risk assessment, and (3) mitigation of identified risks.<sup>266</sup> Given that the Regulation applies to a rather specific area of production and trade, the basic information required to carry out risk assessment is defined in a relatively detailed manner. This gives operators a rather clear idea of what they need to take into account throughout their due diligence process, while at the same time, allowing them to have flexibility depending on the situation in the country of origin. The Regulation also makes provisions for the use of third-party monitoring organisations that develop due diligence systems.<sup>267</sup> With this, the Regulation provides several different routes for businesses to ensure that they comply with the due diligence obligations.

In terms of monitoring compliance, EU member states are required to designate competent authorities that carry out checks on operators, including examinations of the due diligence processes and that their functioning are up to standard.<sup>268</sup> If an operator is found to have violated the Regulation's provisions, member states can take interim actions (such as seizing the timber products involved)<sup>269</sup> and even impose penalties, which must be 'effective, proportionate and dissuasive'.<sup>270</sup> Member states are also required to submit a report every two years to the European Commission on the implementation of the Regulation, which the Commission then summarises for the European Parliament and the European Council.<sup>271</sup>

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263 Ibid, art 4.

264 Ibid, art 5.

265 Ibid, recital 16.

266 Ibid, art 6.

267 Ibid, art 8.

268 Ibid, art 10.

269 Ibid, art 10.5.

270 Ibid, art 19.2.

271 Ibid, art 20.

### 3.4 A Critical Assessment of the Regulation's Due Diligence Provisions

The Regulation's innovative due diligence solution has been widely praised, including by environmental organisations and those in the timber industry. One environmental law non-profit organisation called the Timber Regulation's risk-based approach an 'appropriate tool' that sets out precise requirements for the collection and assessment of relevant information while leaving much flexibility for the way businesses mitigate risks.<sup>272</sup> However, more than six years after the due diligence requirements came into effect, questions still abound about their effective implementation and their impact. The main issue seems to be businesses' confusion about what they need to do in order to meet due diligence obligations, which is especially pressing for smaller enterprises with fewer available resources. Additionally, lagging enforcement efforts by member states have also contributed to criticism over the Regulation.

The two reports published to date by the European Commission on the implementation of the Regulation show that setting up due diligence mechanisms got off to a slow start. During the first two years of the Regulation being in effect, operators' efforts to establish and use due diligence processes remained 'uneven and insufficient', mainly because of not having enough guidance on what such mechanisms should entail.<sup>273</sup> The Commission noted in its 2016 report,

The main barriers to achieve fully operating DD [due diligence] systems include difficulties to understand all the elements needed in order to put in place a solid DDS [due diligence system], difficulties in gathering information on applicable legislation in producer countries, lack of cooperation with suppliers and appropriate risk assessment and mitigation measures.<sup>274</sup>

The report concluded that operators were 'gradually' adopting sufficient due diligence processes, which eventually would lead to considerable changes in the market, however, more time was needed.

The following Commission report published in 2018 had much more information on the enforcement of the Regulation by member states. In terms of compliance with due diligence requirements, there seemed to be differences depending on whether the timber was domestically

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272 ClientEarth, 'The EU Timber Regulation Due Diligence Obligation: An Appropriate Tool' (November 2015) <<https://documents.clientearth.org/wp-content/uploads/library/2015-11-25-the-eu-timber-regulation-due-diligence-obligation-an-appropriate-tool-ce-en.pdf>> accessed 6 June 2019.

273 European Commission, 'Report from the Commission to the European Parliament and the Council: Regulation EU/995/2010 of the European Parliament and of the Council of 20 October 2010 Laying Down the Obligations of Operators who Place Timber and Timber Products on the Market (The EU Timber Regulation)' COM (2016) 74 final, 9.

274 Ibid.

produced or imported. Authorities demanded operators to make changes to their due diligence systems in 3% of the checked operations related to domestic timber and in 17% of the checks for imported wood.<sup>275</sup> Similarly, penalties were imposed for 1.5% of the operators checked in relations to domestic timber and for 4% of them related to imports. Other measures were imposed for 1% of the due diligence systems checked for domestically produced wood and in 10% of checks in case of imports. This shows that ensuring effective due diligence mechanisms seemed to be more difficult for timber products imported from abroad than produced domestically. This most likely has to do with companies having few resources to research foreign legal requirements well enough to implement due diligence mechanisms.

In terms of enforcement, the report noted that member states made ‘steady progress’ towards the implementation of the Regulation, however, there were concerns about the uneven application of rules across EU countries.<sup>276</sup> Concluding that ‘the current level of technical capacity and resources (both human and financial) allocated to the competent authorities does not always correspond to the needs’, the report called on improving such capacities to increase the number of compliance checks carried out by authorities.<sup>277</sup>

Shortcomings of the Regulation have also been noted by civil society organisations. Investigations by Greenpeace have revealed several cases of illegally harvested timber being exported to EU countries even after the Regulation came into effect. A 2015 investigation showed that several EU countries had imported wood products from Cameron despite a high prevalence of illegal logging there.<sup>278</sup> Greenpeace said that given the well-known risk in Cameron, operators were likely not carrying out their due diligence processes adequately if they had imported wood from a specific supplier linked to dubious logging operations. The organisation called on EU authorities to investigate operators listed in its report and fine those businesses that failed to implement the due diligence requirements. This investigation was carried out two years after the Timber Regulation came into effect.

However, five years later, enforcement and adequate due diligence were still lagging. A 2018 investigation by Greenpeace showed that large-scale licensing fraud in Brazil had allowed illegally

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275 European Commission, ‘Report from the Commission to the European Parliament and the Council: Regulation (EU) No 995/2010 of the European Parliament and of the Council of 20 October 2010 Laying Down the Obligations of Operators who Place Timber and Timber Products on the Market (The EU Timber Regulation), Biennial Report for the Period March 2015 – February 2017’ COM (2018) 668 final, 9.

276 Ibid, 12.

277 Ibid.

278 Greenpeace, ‘CCT’s Timber Trade from Cameron to Europe: A Test Case for EUTR’s Due Diligence Requirement’ (September 2015) <[https://www.illegal-logging.info/sites/files/chlogging/Greenpeace%20%282015%29%20CCT\\_rapport\\_sept15\\_03.pdf](https://www.illegal-logging.info/sites/files/chlogging/Greenpeace%20%282015%29%20CCT_rapport_sept15_03.pdf)> accessed 28 June 2019.

harvested timber from the Amazon region to reach a number of EU countries.<sup>279</sup> The investigation found that unreliable licensing processes had allowed for fraudulent or accidental overestimation of timber available for logging, allowing suppliers to provide seemingly legitimate documentation for illegally logged wood. Greenpeace recommended that EU authorities find companies in breach of their due diligence obligations if they haven't taken steps to ensure the legality of logging beyond using such highly unreliable official documentation.<sup>280</sup>

These examples show that while the application of the due diligence principle is theoretically effective, such binding measures can only work if companies are given clear guidance on what effective due diligence looks like and authorities are willing to enforce such laws. While strict requirements and enforcement might burden companies – especially small operations – at first, a stronger approach would allow for a clear understanding of what is necessary to comply with due diligence obligations. This is crucial for such legislation to succeed.

The Timber Regulation also illustrates some of the possible pitfalls of global supply chain due diligence. While the Regulation applies to a relatively narrow sector, it is clear that conducting due diligence for products coming from abroad can be challenging, at best, and impossible, at worst. Businesses need to establish facts and ensure their veracity from afar. For this, they need to cross not only language barriers but also familiarise themselves with local laws and political situations. Even if everything looks legal and in order on paper, as the above-mentioned example of the 2018 Greenpeace investigation shows, the reality of the situation might still be impossible to establish without carrying out thorough investigations on site and having knowledgeable contacts on the ground. When this is not feasible, businesses need to decide whether the information they have is reliable enough, or if it's better to err on the side of caution and not go ahead with the transaction at all. In such situations, it might be helpful if regulators established clearly-defined guidelines or issue country-specific guidance concerning possible risks. Here, the goal should be to minimise risks by striking a balance between overly restrictive measures and too much leeway.

The EU's Timber Regulation was an important development enshrining the principle of due diligence as such for the first time in the Union. As the aim of stopping illegally harvested timber from reaching the EU market needed an innovative approach, regulators arrived at due diligence after a thorough consultation process that showed the complexity of the issue. The Regulation was drafted to allow for a high level of flexibility to minimise the burden on businesses, however, as subsequent reports have shown, this created confusion as to what exactly due diligence processes

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279 Greenpeace, 'Imaginary Trees, Real Destruction: How Licensing Fraud and Illegal Logging of Ipe Trees Are Causing Irreversible Damage to the Amazon Rainforest' (20 March 2018) <[https://storage.googleapis.com/planet4-international-stateless/2018/03/b91d03c3-greenpeace-report\\_imaginary-trees-real-destruction\\_march-2018.pdf](https://storage.googleapis.com/planet4-international-stateless/2018/03/b91d03c3-greenpeace-report_imaginary-trees-real-destruction_march-2018.pdf)> accessed 28 June 2019.

280 Ibid, 27.

should include. This was further compounded by the low level of enforcement by EU member states. While the European Commission has noted progress in the implementation of the Regulation, it has become clear that due diligence laws require clarity and willingness from authorities to enforce them in order to be successful. Thus, while progress has been made through due diligence requirements to crack down on illegally harvested timber in the EU, it remains to be seen if the EU's due diligence obligations alone can lead to far-reaching changes in the global timber industry.



## **Chapter 4: Mandatory Human Rights Due Diligence – The Conflict Minerals Regulation**

### **4.1 The Nature of Mandatory Human Rights Due Diligence**

After examining due diligence reporting requirements and mandatory due diligence aimed at combatting illegal activities, we arrive at the most direct way of implementing respect for human rights as enshrined in the UNGPs: mandatory human rights due diligence. In such legislation, the aim is to prevent human rights abuses through the use of due diligence. Whereas in the other above-discussed legislative acts the impact on human rights is rather secondary, the intended effect here is directly reducing such violations in business. Mandating human rights due diligence acknowledges the primacy of respect for such rights over other considerations. While the ultimate duty to uphold human rights still rests with states, mandatory human rights due diligence does confer responsibility to businesses to respect human rights by taking into account the far-reaching consequences of their activities.

Having a specific focus on human rights – as opposed to carrying out general due diligence that has some considerations connected to human rights as part of risk management – can have a dramatic impact. Using human rights due diligence, whose focus is on the rights-holders potentially harmed by business activities, can improve the likelihood of companies discovering and mitigating possible violations. In fact, a survey of more than 150 businesses has shown that of the companies with dedicated human rights due diligence mechanisms, 77% identified adverse impacts connected to their activities, while of the companies that did not use dedicated human rights risk processes, 81% did not identify such impacts.<sup>281</sup> Additionally, when companies use an expressly human rights framework, they are more likely to identify possible violations throughout their supply chain, take effective action to mitigate those impacts, track those actions, consult human rights experts and focus on a wider range of rights.<sup>282</sup> Thus, putting human rights at the centre can have far-reaching implications.

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281 Robert McCorquodale and others, 'Human Rights Due Diligence in Law and Practice: Good Practices and Challenges for Business Enterprises' (2017) 2 *Business and Human Rights Journal* 195.

282 *Ibid.*, 221.

## 4.2 Human Rights Violations in the Mining Industry and the OECD Guidance

One area of business that has been rife with human rights violations is mining. While extracting minerals has long been associated with violence and abuses, including in the colonial context, the discussion on the human rights impact of mining came to the fore in earnest in the mid-1990s.<sup>283</sup> Several human rights issues affecting indigenous and local populations became visible during this time (often intertwined with the environmental impacts of mining). These included: increased poverty, growing inequality, internal conflicts, militarisation, forced displacement, increased sexual violence, violations of labour standards, such as the use of child labour, and destruction of cultural heritage, among others.<sup>284</sup> By the early 2000s, a number of codes of conduct and guidelines had been drafted, however, all of them were voluntary, leaving it up to companies to decide whether to abide by them.<sup>285</sup>

The existence of armed conflict fuelled in part by the exploitation of natural resources has also been a known problem in the international community for a while. The issue, while present in other parts of the world, has been especially prevalent in Africa's Great Lakes Region. In 2005, the UN Security Council noted that 'the link between the illegal exploitation of natural resources, the illicit trade in those resources and the proliferation and trafficking of arms is one of the factors fuelling and exacerbating conflicts in the Great Lakes Region of Africa, and especially in the Democratic Republic of the Congo', calling on neighbouring countries to stop the flow of such resources into their territories.<sup>286</sup> To combat the exploitation and trade of what became known as conflict minerals, the Security Council called for the use of due diligence for importers, processors and consumers of mineral products from the Democratic Republic of the Congo (DRC) in a 2010 resolution.<sup>287</sup> The scope of risk mitigation here was somewhat narrower than general human rights due diligence: it was meant to reduce direct or indirect support to illegal armed groups, individuals and entities under targeted sanctions, and 'criminal networks and perpetrators of serious violations of international humanitarian law and human rights abuses'.<sup>288</sup> This was the first instance of the Security Council urging due diligence in the area of business activity as a means of reducing conflict.

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283 Marta Miranda, David Chambers, and Catherine Coumans, 'Framework for Responsible Mining: A Guide to Evolving Standards' (19 October 2005) <[http://frameworkforresponsiblemining.org/pubs/Framework\\_20051018.pdf](http://frameworkforresponsiblemining.org/pubs/Framework_20051018.pdf)> accessed 10 June 2019.

284 Ibid, 48-49.

285 Simon D Handelsman, 'Human Rights in the Minerals Industry' (Mining, Minerals and Sustainable Development Report No 9, January 2002) <<https://pubs.iied.org/pdfs/G00531.pdf>> accessed 11 June 2019.

286 UN Security Council, Resolution 1649 (2005) (21 December 2005).

287 UN Security Council, Resolution 1952 (2010) (29 November 2010).

288 Ibid, para 7.

It was in this context that the *OECD Due Diligence Guidance for Responsible Supply Chains of Minerals from Conflict-Affected and High-Risk Areas* (OECD Guidance) was developed in 2011 through a multi-stakeholder process including the OECD, governments from the Great Lakes Region, the UN and civil society.<sup>289</sup> This was among the first sector-specific due diligence guidelines developed with reference to the UNGPs. The OECD Guidance contains a general due diligence framework for the management of mineral supply chains in conflict-affected or high-risk areas and two supplements – one on supply chain due diligence for tin, tantalum and tungsten, and another one for gold. The document, which is not legally binding, defines its main purpose as helping ‘companies respect human rights and avoid contributing to conflict through their sourcing decisions, including the choice of their suppliers’.<sup>290</sup> The OECD Guidance further notes that carrying out such human rights due diligence can contribute to sustainable development and promote transparency throughout supply chains.<sup>291</sup> The document lays out a five-step process for carrying out supply chain due diligence, which consists of: (1) establishing strong management systems in the company, (2) identifying and assessing risks, (3) designing and implementing strategies to address those risks, (4) carrying out independent third-party audits of due diligence systems, and (5) reporting publicly on due diligence policies.<sup>292</sup> While noting that it might be too early to judge the effectiveness of the OECD Guidance, commentators have praised the use of the human rights due diligence process described in it for focusing on steps that are in companies’ power to take.<sup>293</sup> The Guidance has been endorsed by several key players, including governments in the Great Lakes Region,<sup>294</sup> the Security Council,<sup>295</sup> the US<sup>296</sup> and China,<sup>297</sup> among others.

### 4.3 The EU’s Conflict Minerals Regulation

The EU has also been a strong supporter of the OECD Guidance, and in 2017, the Union adopted legislation making the supply chain due diligence measures outlined in it binding for EU

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289 OECD, *OECD Due Diligence Guidance for Responsible Supply Chains of Minerals from Conflict-Affected and High-Risk Areas* (3rd edn, OECD Publishing, 2016) (OECD Guidance).

290 Ibid, 12.

291 Ibid.

292 Ibid, 17-19.

293 Holly Cullen, ‘The Irresistible Rise of Human Rights Due Diligence: Conflict Minerals and Beyond’ (2016) 48 *Geo Wash Int’l Rev* 743.

294 International Conference on the Great Lakes Region, ‘Lusaka Declaration of the ICGLR Special Summit to Fight Illegal Exploitation of Natural Resources in the Great Lakes Region’ (15 December 2010).

295 UN Security Council, Resolution 2021 (2011) (29 November 2011).

296 US Securities and Exchange Commission, ‘Conflict Minerals: Final Rule’ (22 August 2012) Release No 34-67716, File No S7-40-10.

297 China Chamber of Commerce Metals, Minerals & Chemicals Importers and Exporters, ‘Chinese Due Diligence Guidelines for Responsible Mineral Supply Chains’ (2 December 2015).

importers of certain minerals from conflict-affected and high-risk regions.<sup>298</sup> The legislation, what is now known as the EU's Conflict Minerals Regulation, is set to enter fully into force on 1 January 2021, becoming one of the leading examples of mandatory human rights due diligence in the world.

However, the road to the adoption of the Regulation was not easy. When the EU institutions began negotiations, it was not clear that the Union was ready to lay down mandatory due diligence requirements. Inspired by a 2010 US legislation known as the Dodd-Frank Act, the European Parliament had called for mandatory due diligence for EU importers of conflict minerals.<sup>299</sup> However, in its legislative proposal, the European Commission recommended laying down 'supply chain due diligence obligations of Union importers who choose to be self-certified as responsible importers'.<sup>300</sup> The Commission had previously outlined six different options ranging from issuing communications on the issue all the way to banning the import of certain minerals into the EU unless companies can demonstrate compliance with the OECD Guidance.<sup>301</sup> The legislative proposal contained what the Commission perceived as the most prudent course of action: establishing a due diligence framework based on the OECD Guidance for EU companies that want to be certified as 'responsible importers'.<sup>302</sup> However, the European Parliament was keen on setting up a more binding framework. In amendments to the Commission's proposal, the Parliament specified that it wanted to lay down supply chain due diligence for 'all Union importers who source minerals and metals falling within the scope of this Regulation, in accordance with the OECD Due Diligence Guidance'.<sup>303</sup> The Parliament's strong position was hailed by civil society organisation, which warned member states against 'watering down' the proposal during the legislative process.<sup>304</sup>

In the end, the Regulation adopted a year later indeed set up mandatory due diligence requirements for importers of certain minerals instead of mere voluntary measures. The aim of the legislation is to 'curtail opportunities for armed groups and security forces to trade' in minerals covered by the Regulation and to 'provide transparency and certainty as regards to the supply

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298 Regulation (EU) 2017/821 of the European Parliament and of the Council of 17 May 2017 laying down supply chain due diligence obligations for Union importers of tin, tantalum and tungsten, their ores, and gold originating from conflict-affected and high-risk areas (Conflict Minerals Regulation) [2017] OJ L 130/1.

299 European Parliament resolution of 7 October 2010 on failures in protection of human rights and justice in the Democratic Republic of Congo P7\_TA (2010) 0350.

300 European Commission, 'Proposal for a Regulation of the European Parliament and of the Council Setting up a Union System for Supply Chain Due Diligence Self-Certification of Responsible Importers of Tin, Tantalum and Tungsten, their Ores, and Gold Originating in Conflict-Affected and High-Risk Areas' COM (2014) 111 final, 10.

301 Ibid, 4-5.

302 Ibid, 5.

303 Amendments adopted by the European Parliament on 20 May 2015 on the proposal for a regulation of the European Parliament and of the Council setting up a Union system for supply chain due diligence self-certification of responsible importers of tin, tantalum and tungsten, their ores, and gold originating in conflict-affected and high-risk areas (COM (2014) 0111 – C7-0092/2014 – 2014/0059(COD)) P8\_TA (2015) 0204, amendment 154.

304 CIDSE, 'EU Member States Are Watering Down Proposals That Would Help Stop Conflict Minerals' (6 April 2016) <<https://cidse.org/newsroom/eu-member-states-are-watering-down-proposals-that-would-help-stop-conflict-minerals.html>> accessed 11 June 2019.

practices of Union importers’.<sup>305</sup> The preamble of the Regulation explains that ‘breaking the nexus between conflict and illegal exploitation of minerals’ was critical to ensuring peace, security and development,<sup>306</sup> while also mentioning the threat of such activities to human rights.<sup>307</sup> Such a clear reference to human rights makes this Regulation much stronger than the other two EU laws analysed in terms of setting up dedicated human rights due diligence.

In terms of its main content, the Regulation essentially turns the voluntary OECD Guidance into a mandatory due diligence framework for EU importers of tin, tantalum and tungsten, their ores, and gold. In line with step one of the OECD Guidance, importers under the Regulation’s scope are required to set up internal management systems to support due diligence, including supply chain traceability and grievance mechanisms.<sup>308</sup> The EU specified risk management obligations to include identification and assessment of risks (corresponding to step two of the OECD Guidance), and the implementation of strategies to mitigate or prevent the identified risks (step three of the OECD Guidance).<sup>309</sup> Further, importers are required to commission independent third-party audits of their supply chain due diligence practices to make sure they are in line with the Regulation (step four of the OECD Guidance).<sup>310</sup> Finally, importers need to make third-party audits available to authorities, provide information on their supply chain to their purchasers and publicly report on their due diligence mechanisms (step five of the OECD Guidance).<sup>311</sup> The Regulation also sets up a mechanism to recognise due diligence schemes that importers can opt to use to fulfil their due diligence requirements.<sup>312</sup>

The wording of the Regulation – and that of the OECD document that it relies on – ensure the law’s potential for success as the EU’s first full-fledged human rights due diligence requirement. The Regulation is the strongest EU legislation to date translating human rights due diligence as set out in UNGPs (and OECD documents developed building on that process) into binding measures. The aim of the legislation is to stop human rights violations, and it requires dedicated human rights due diligence. Companies under the scope of the legislation must use human rights language in their due diligence, focusing on the risk of violations against affected persons and communities. Thus, the Regulation ensures that due diligence isn’t merely carried out as a way to manage reputational risks but is actually directed at minimising the risks to affected stakeholders.

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305 Conflict Minerals Regulation, art 1.1.

306 Ibid, recital 1.

307 Ibid, recital 3.

308 Ibid, art 4.

309 Ibid, art 5.

310 Ibid, art 6.

311 Ibid, art 7.

312 Ibid, art 8.

Given the well-documented link between conflict minerals and human rights violations, the parameters of what specific issues might arise during the extraction, trade and transit of minerals in conflict-affected and high-risk areas are fairly well-defined in the OECD Guidance, which the Regulation specifically points to. The legislation calls on EU importers to adopt ‘risk management measures consistent with Annex II to, and the due diligence recommendations set out in, the OECD Due Diligence Guidance’.<sup>313</sup> The model supply chain policy included in the OECD Guidance identifies the following violations: torture; cruel, inhuman and degrading treatment; forced or compulsory labour; child labour; other gross human rights violations such as sexual violence; and war crimes or other serious violations of international humanitarian law.<sup>314</sup> While the list is by no means exhaustive and allows for flexibility when assessing different situations, it does provide a more precise framework on what possible human rights violations due diligence systems should be looking for than, for example, the EU’s Timber Regulation, which is tied to illegality under local laws. This narrower and more defined focus on human rights has the potential to lead to more effective implementation.

The Regulation strikes a good balance between encouraging trade and yet, at the same time, ensuring that supply chains are as free as possible of human rights violations. It does this by mandating importers to ‘take steps to exert pressure on suppliers who can most effectively prevent or mitigate’ risks through the following options: (1) continuing trade while implementing risk mitigation, (2) temporarily suspending trade while risk mitigation takes place, and (3) ending trade relations if risk mitigation efforts have failed.<sup>315</sup> Companies are free to choose any of these three options, however, the fact that the Regulation doesn’t shy away from recommending that importers terminate relationships with suppliers if risks cannot be adequately mitigated shows that due diligence is not meant to be just a box-ticking exercise but a mechanism that has far-reaching impact on business operations.

The Regulation applies to EU importers of tin, tantalum and tungsten, their ores, and gold, if the annual import volumes exceed specific thresholds.<sup>316</sup> The Commission estimates that the Regulation will directly apply to 600 to 1,000 EU importers, and will also indirectly affect 500 smelters and refiners that are in the supply chains of EU companies regardless of where they are based.<sup>317</sup> The minerals included under the scope of the Regulation are used in everyday products

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313 Ibid, art 5.1(b)(ii).

314 OECD Guidance (n 289) 20-21.

315 Conflict Minerals Regulation, art 5.1(b)(ii).

316 Ibid, art 1.2.

317 European Commission, ‘The Regulation Explained’ (date published not available) <<http://ec.europa.eu/trade/policy/in-focus/conflict-minerals-regulation/regulation-explained/>> accessed 12 June 2019.

around the world such as computers, mobile phones and jewellery, and are known to be a source of revenue for armed groups operating in conflict-ridden areas.<sup>318</sup>

It is important to note here that companies have different obligations depending on their place in the supply chain. Upstream companies, defined as those extracting, processing, trading and refining raw materials, have to comply with the due diligence obligations set out in the Regulation. Downstream firms, meaning those involved in the supply chain after the smelting and refining process, can be separated into two further categories: those importing metal-stage products, which fall under the due diligence obligations; and those beyond the metal stage, which don't fall under the scope of the Regulation, even though, they might fall under the scope of the NFR Directive.<sup>319</sup> Under that Directive, companies have to publicly disclose non-financial information, including their due diligence processes. However, its scope is one of the points where the Conflict Minerals Regulation is considered to have fallen short.<sup>320</sup> The legislation only applies to companies that import raw materials (minerals and metals) into the EU. This leaves a lot of businesses further down the supply chain – such as importers of semi-processed materials or finished products – not covered by the requirements. Some critics see this as a missed opportunity on the EU's part to exert pressure on a much broader swathe of businesses to ensure that their products are responsibly sourced.<sup>321</sup>

Scope is also an issue when considering the exemptions granted based on volume thresholds. The Regulation specifies that due diligence requirements will apply to those importing 'the vast majority, but no less than 95%, of the total volumes' of each mineral and metal into the EU.<sup>322</sup> As the annexed list of volume thresholds shows, this means, for example, that companies importing less than 100 kg of gold (both unrefined and refined) are not covered by the due diligence obligations.<sup>323</sup> Critics have noted that this leaves about 90% of gold importers exempt from the due diligence requirements because they don't meet the 100-kg threshold.<sup>324</sup> As Amnesty International warned during the legislative process, the exemption threshold is also questionable given that 100 kg of gold can still generate large amounts of income<sup>325</sup> – at current prices, 100 kg of gold costs in

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318 Ibid.

319 Ibid.

320 Global Witness, 'EU Political Agreement on Conflict Minerals Risks Allowing a Deadly Trade to Continue' (16 June 2016) <<https://globalwitness.org/en/press-releases/eu-political-agreement-conflict-minerals-risks-allowing-deadly-trade-continue/>> accessed 13 June 2019.

321 Ibid.

322 Conflict Minerals Regulation, art 1.3.

323 Ibid, annex I.

324 EurAc, 'European Regulation on the Responsible Sourcing of Minerals: The EU Is (Once Again) About to Weaken the Upcoming Regulation' (Policy Briefing, 10 November 2016) <[https://eurac-network.org/sites/default/files/conflict\\_minerals\\_the\\_eu\\_is\\_once\\_again\\_about\\_to\\_weaken\\_the\\_upcoming\\_regulation\\_-\\_eurac\\_-\\_10\\_november\\_2016.pdf](https://eurac-network.org/sites/default/files/conflict_minerals_the_eu_is_once_again_about_to_weaken_the_upcoming_regulation_-_eurac_-_10_november_2016.pdf)> accessed 13 June 2019.

325 Amnesty International, 'EU: Loopholes in Regulation Risk Allowing Trade in Conflict Minerals to Continue' (17 November 2016) <<https://amnesty.eu/news/eu-loopholes-in-regulation-risk-allowing-trade-in-conflict-minerals-to-continue-1007/>> accessed 27 June 2019.

the vicinity of €3.8m,<sup>326</sup> which is a rather large amount of money considering that it could go towards funding conflicts. The effectiveness of the Regulation here will come down to the European Commission's willingness to amend volume thresholds, which it is empowered to do every three years after 2021.<sup>327</sup>

In terms of geographic reach, the companies under the scope of the Regulation have to carry out supply chain due diligence regardless of whether the minerals or metals come from conflict-affected or high-risk areas. When they find that the products indeed originate from such areas, importers have to seek out additional information to practice enhanced vigilance in such situations.<sup>328</sup> The Regulation defines conflict-affected and high-risk areas as regions 'in a state of armed conflict or fragile post-conflict as well as areas witnessing weak or non-existent governance and security, such as failed states, and widespread and systemic violations of international law, including human rights abuses'.<sup>329</sup> This formulation, which was later expounded on in a non-binding guidance<sup>330</sup> by the European Commission, allows for a dynamic interpretation of conflict-affected and high-risk areas. This means that the reach of the Regulation is global, instead of being tied to certain regions, and the need for enhanced due diligence is dependent on the situation on the ground. This is in line with the risk-based approach that is at the heart of due diligence.

Additionally, the European Commission is also set to publish an 'indicative, non-exhaustive, regularly updated list of conflict-affected and high-risk areas' based on recommendations of external experts.<sup>331</sup> The Regulation notes that just because a specific region where an EU importer sources its material from is not included on the forthcoming list doesn't mean that the importer is exempt from having to comply with the due diligence obligations. However, some critics have noted that establishing such a list might become a highly politicised exercise with possible negative implications for the regions listed, as EU importers might be reluctant to source minerals and metals from there.<sup>332</sup> Others have warned that such designations of specific areas might also run afoul of World Trade Organisation (WTO) rules, which 'prohibit discriminatory measures detrimentally affecting competitive opportunities of like products from all WTO Members'.<sup>333</sup> If a WTO member

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326 Current price of gold on 13 June 2019 according to *Goldprice* <<https://goldprice.org/gold-price-per-kilo.html>> accessed 13 June 2019.

327 Conflict Minerals Regulation, art 1.5

328 Ibid, art 4(f)(v) and art 4(g)(v).

329 Ibid, art 2(f).

330 Commission Recommendation (EU) 2018/1149 of 10 August 2018 on non-binding guidelines for the identification of conflict-affected and high-risk areas and other supply chain risks under Regulation (EU) 2017/821 of the European Parliament and of the Council [2018] OJ L208/94.

331 Conflict Minerals Regulation, art 14.2.

332 Karin Kublbock and Hannes Grohs, 'EU Regulation on "Conflict Minerals": A Step Towards Higher Accountability in the Extractive Sector?' (2017) Policy Note, Austrian Foundation for Development Research (ÖFSE), No 18a/2017, 3 <<http://hdl.handle.net/10419/175085>> accessed 14 June 2019.

333 Enrico Partiti and Steffen van der Velde, 'Curbing Supply-Chain Human Rights Violations Through Trade and Due Diligence. Possible WTO Concerns Raised by the EU Conflict Minerals Regulation' (2017) Asser Research Paper



were to initiate a dispute over alleged discrimination caused by the Regulation, the EU would have to prove that the measures taken were justified under WTO rules.

The enforcement of the Regulation is to be carried out by competent authorities designated by each EU member state through conducting *ex-post* checks of the given company's supply chain due diligence mechanism, records of compliance with that mechanism and audit obligations.<sup>334</sup> When infringements are identified, authorities are to issue a 'notice of remedial action to be taken' by the company.<sup>335</sup> The Regulation provides for no other measures, which civil society organisations have criticised for setting 'an extremely low bar for accountability', calling on member states to put in place appropriate measures to sanction companies when they commit violations.<sup>336</sup> In terms of reporting, EU countries are required to submit annual reports to the European Commission on the implementation of the Regulation, which will inform the Commission's review of the effectiveness of the legislation to be published every three years starting in 2023.<sup>337</sup> At this point, as the Regulation is still in the process of being implemented and its due diligence obligations won't come into force until 2021, it is difficult to assess its impact.

#### **4.4 A Comparison of the EU and US Conflict Minerals Laws**

While the effectiveness of the EU law has yet to be seen, some conclusions can already be drawn because the EU legislation is not the first one to introduce due diligence and reporting requirements for conflict minerals. It is in fact modelled on a 2010 US legislation known as Section 1502 of the Dodd-Frank Act.<sup>338</sup> The European Parliament made direct reference to this US law in 2010, calling on the European Commission to develop a proposal for similar legislation.<sup>339</sup> The following brief analysis will outline the main features of the US law, its implementation and how the EU legislation compares to its US counterpart.

The US conflict minerals legislation was passed as part of a large-scale legislative effort by former US President Barack Obama to overhaul financial regulation in the aftermath of the 2008 global financial crisis. Section 1502 of the Dodd-Frank Act aimed to crack down on the exploitation and trade of minerals originating from the DRC because such activities were 'helping to finance

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2017-02.

334 Conflict Minerals Regulation, art 11.

335 *Ibid*, art 16.

336 Amnesty International and others, 'Joint Policy Note: Ensuring the Proper Implementation of the EU Regulation on the Responsible Sourcing of Minerals from Conflict-Affected and High-Risk Areas' (25 April 2019) <[https://amnestyeu.azureedge.net/wp-content/uploads/2019/04/Policy-Note\\_Implementation.pdf](https://amnestyeu.azureedge.net/wp-content/uploads/2019/04/Policy-Note_Implementation.pdf)> accessed 13 June 2019.

337 Conflict Minerals Regulation, art 17.

338 Dodd-Frank Wall Street Reform and Consumer Protection Act 2010 (Dodd-Frank Act) (US).

339 European Parliament resolution of 7 October 2010 (n 299).

conflict characterized by extreme levels of violence in the eastern Democratic Republic of the Congo, particularly sexual- and gender-based violence, and contributing to an emergency humanitarian situation therein'.<sup>340</sup> Under the final rule issued in 2012 by the US Security and Exchange Commission (SEC),<sup>341</sup> which was tasked with the implementation of the legislation, all publicly-traded companies in the US are required to disclose whether their supply chain contained any tin, tantalum, tungsten or gold sourced from the DRC and adjoining countries. If companies do source minerals from those countries, they are required to show that they have undertaken due diligence. The final rule developed by the SEC notably endorsed the OECD Guidance as a recognised due diligence framework.

The legislation, which was to be applied starting 1 January 2013, has not been without controversy. After a legal challenge had been lodged against the disclosure requirements specified by the SEC, a US appeals court upheld the provisions for the most part in April 2014, while leaving some issues open.<sup>342</sup> Subsequently, the first batch of reports on conflict minerals were filed in June 2014. However, President Donald Trump has vowed to eliminate Section 1502 – along with other parts of the Dodd-Frank Act.<sup>343</sup> Acting SEC Chairman Michael Piowar announced in January 2017 that the agency would reconsider the rules regarding the implementation of the conflict minerals provisions.<sup>344</sup> In April 2017, the SEC announced that due to uncertainties regarding reporting requirements, it would not 'recommend enforcement action' if companies failed to file conflict minerals reports.<sup>345</sup> This move left the legislation's implementation and future highly uncertain. In June 2018, a large group of institutional investors issued a statement calling on companies to continue filing such reports, while noting with disappointment that a handful of companies explicitly stated that they had decided not to file conflict minerals reports as 'a direct response' to Piowar's statement.<sup>346</sup>

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340 Dodd-Frank Act, sec 1502(a).

341 US Securities and Exchange Commission (n 296).

342 Kieth F Higgins, 'Statement on the Effect of the Recent Court of Appeals Decision on the Conflict Minerals Rule' (29 April 2014) US Securities and Exchange Commission <<https://sec.gov/news/public-statement/2014-spch042914kfh>> accessed 14 June 2019.

343 Ed Pilkington, 'Proposed Trump Executive Order Would Allow US Firms to Sell "Conflict Minerals"' *The Guardian* (8 February 2017) <<https://theguardian.com/us-news/2017/feb/08/trump-administration-order-conflict-mineral-regulations>> accessed 14 June 2019.

344 Michael S Piowar, 'Reconsideration of Conflict Minerals Rule Implementation' (31 January 2017) US Securities and Exchange Commission <<https://sec.gov/news/statement/reconsideration-of-conflict-minerals-rule-implementation.html>> accessed 15 June 2019.

345 US Securities and Exchange Commission Division of Corporation Finance, 'Updated Statement on the Effect of the Court of Appeals Decision on the Conflict Minerals Rule' (7 April 2017) <<https://sec.gov/news/public-statement/corpfm-updated-statement-court-decision-conflict-minerals-rule>> accessed 14 June 2019.

346 Investor Alliance for Human Rights, 'Investor Expectations on Conflict Mineral Reporting' (June 2018) <[https://investorsforhumanrights.org/sites/default/files/attachments/2018-06/InvestorExpectationsConflictMineralReporting\\_5.31.18\\_FINAL.pdf](https://investorsforhumanrights.org/sites/default/files/attachments/2018-06/InvestorExpectationsConflictMineralReporting_5.31.18_FINAL.pdf)> accessed 14 June 2019.

When it comes to the measurable impact of the US conflict minerals law, the picture is complicated. On one hand, civil society organisations have applauded the legislation, noting a ‘major reduction’ in the number of mines connected to conflict in the eastern DRC.<sup>347</sup> The anti-corruption NGO Global Witness wrote that because of the US legislation, miners on the ground were more aware of their rights and there was increased monitoring of mining operations.<sup>348</sup> The NGO warned that efforts by the Trump administration to suspend or repeal Section 1502 threatened to ‘undermine global responsible sourcing efforts’, calling for further strengthening of the legislation.<sup>349</sup> On the other hand, the limited research that has been conducted has shown that the legislation has, in fact, largely misfired. The increased transparency and due diligence obligations led to a *de facto* boycott of minerals sourced from the DRC, because companies found it easier to avoid falling under the purview of the legislation than to carry out due diligence.<sup>350</sup> This was coupled with a six-month ban on mining in the eastern DRC introduced by Congolese President Joseph Kabila in September 2010,<sup>351</sup> resulting in devastating economic hardships for local mining communities, especially artisanal miners.<sup>352</sup> A 2016 United Nations University study showed that infant mortality rose by more than 140% in affected communities as an unforeseen consequence of the Dodd-Frank Act.<sup>353</sup> Additionally, it has been shown that since the legislation entered into force, there have been increases in battles, looting and violence against civilians on the ground, especially around gold mines.<sup>354</sup> In a 2014 open letter, 70 Congolese academics and experts summed up the situation by writing that ‘the conflict minerals campaign fundamentally misunderstands the relationship between minerals and conflict in the eastern DRC’, noting that while the exploitation of minerals contributed to the conflict, it was not the root cause of it.<sup>355</sup>

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347 Enough Project, ‘Progress and Challenges on Conflict Minerals: Facts on Dodd-Frank 1502’ (June 2018) <<https://enoughproject.org/wp-content/uploads/Progress-and-challenges-June-2018.pdf>> accessed 14 June 2019.

348 Global Witness, ‘US Conflict Minerals Law – Section 1502 of US Dodd Frank Act: The Landmark US Law Requiring Responsible Minerals Sourcing’ (15 November 2017) <<https://globalwitness.org/en/campaigns/conflict-minerals/dodd-frank-act-section-1502/>> accessed 14 June 2019.

349 Ibid.

350 Paivi Poyhonen, Kristina Areskog Bjurling and Jeroen Cuvelier, ‘Voices from the Inside: Local Views on Mining Reform in Eastern DR Congo’ (published by Finnwatch and Swedwatch, October 2010).

351 BBC News, ‘DR Congo Bans Mining in Eastern Provinces’ (11 September 2010) <<https://bbc.com/news/world-africa-11269360>> accessed 15 June 2019.

352 Jeroen Cuvelier and others, ‘Analyzing the Impact of the Dodd-Frank Act on Congolese Livelihoods’ (Conflict Prevention and Peace Forum, November 2014).

353 Dominic P Parker, Jeremy D Foltz and David Elsea, ‘Unintended Consequences of Economic Sanctions for Human Rights: Conflict Minerals and Infant Mortality in the Democratic Republic of the Congo’ (November 2016) WIDER Working Paper 2016/124.

354 Nik Stoop, Marijke Verpoorten and Peter van der Windt, ‘More Legislation, More Violence? The Impact of Dodd-Frank in the DRC’ (2018) PLoS ONE 13(8): e0201783 <<https://doi.org/10.1371/journal.pone.0201783>> accessed 15 June 2019.

355 ‘An Open Letter: Dear governments, companies, non-governmental organisations, and other stakeholders implicated in efforts of various kinds related to the issue of “conflict minerals”’ (9 September 2014) <<https://ethuin.files.wordpress.com/2014/09/09092014-open-letter-final-and-list.pdf>> accessed 15 June 2019.

It was against this backdrop that the EU drafted its Conflict Minerals Regulation. As the EU used the Dodd-Frank Act as a model for its legislation, the main provisions on transparency and due diligence are largely overlapping. The main differences lie in the scope and geographic reach of the two laws. Many of the unintended negative consequences of the US legislation can be tied to its limited geographic reach: companies not wanting to carry out enhanced due diligence in order to source minerals from the DRC and neighbouring countries could simply decide to disengage from the region and seek out minerals sourced elsewhere. The EU legislation is global in its reach, calling for enhanced due diligence when minerals originate from conflict-affected or high-risk areas anywhere in the world. This wide reach may minimise the negative impact on local mining communities, as companies won't be incentivised to just abandon certain regions. The full impact of the Conflict Minerals Regulation will also depend on the provisional list of conflict-affected and high-risk areas that the EU is expected to publish: if the list is too narrow, there might still be regions that EU importers may boycott altogether to seek less risky areas.

At the same time, the US legislation's scope of the companies covered is considerably wider than that of the EU. The Dodd-Frank Act applies to all companies using tin, tantalum, tungsten and gold if 'the minerals are "necessary to the functionality or production" of a product manufactured or contracted to be manufactured by the company'.<sup>356</sup> This provides for a much wider scope than the EU's legislation, which applies only to importers of raw materials, leaving producers further down the supply chain outside the scope. Commentators have pointed out that a majority of importers covered by the EU legislation already fall under the scope of the US law, making the almost four-year phasing-in period for the new EU rules unexplainably long.<sup>357</sup> It remains to be seen if the EU has the political will in the future to widen the scope of the legislation to include more downstream companies.

Lastly, the political developments in the US, including the fate of the Dodd-Frank Act, will be important to watch for the EU. While there are good reasons to reconsider the effectiveness of the US conflict minerals legislation, it is clear that the Trump administration has been mainly motivated by the opinion that the legislation is too costly and burdensome for companies.<sup>358</sup> With the US legislation essentially suspended, it is highly possible that the EU rules will be the only ones requiring due diligence when they come into effect in 2021. This might put EU importers into a disadvantaged position in terms of competition. It will be essential for the EU to ensure rigorous

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356 US Securities and Exchange Commission, 'Fact Sheet: Disclosing the Use of Conflict Minerals' (date published not available) <<https://sec.gov/opa/Article/2012-2012-163htm---related-materials.html>> accessed 15 June 2019.

357 Kublbock and Grohs (n 332) 3.

358 Sara Greenen, 'Trump Is Right on Congo's Minerals, but for All the Wrong Reasons' *The Conversation* (22 February 2017) <<https://theconversation.com/trump-is-right-on-congos-minerals-but-for-all-the-wrong-reasons-73320>> accessed 15 June 2019.

implementation of the new rules, which might benefit from strong civil society support for the elimination of conflict minerals from EU supply chains.

It is clear that the EU Conflict Minerals Regulation with its global reach is a groundbreaking development in the use of mandatory due diligence. The process of establishing dedicated human rights due diligence mechanisms will be important to study as it will give insight into the elements and practices needed to ensure the effectiveness of such mechanisms. Enforcement, implementation and continuous review of the Regulation will also be essential for successful outcomes. In the face of growing discontent against business regulation, especially in the US, it will be imperative for the EU to stand up for increased requirements for businesses to ensure respect for human rights. At the same time, it is important to see that due diligence is an initial step towards minimising human rights abuses – in this case, connected to conflict minerals – and taking a holistic view of situations on the ground is highly needed to resolve conflicts.

## **Conclusions**

Mandatory human rights due diligence has emerged as one of the main regulatory tools to implement the UNGPs. It provides a flexible solution that aims to minimise the risk of human rights abuses in the course of business activities. The above chapters considered the nature of human rights due diligence from a philosophical perspective and analysed existing European Union legislation with due diligence aspects to identify main trends that should be considered when looking at further such measures. It is clear that human rights due diligence is a valuable tool that can have a real impact on companies' operations, however, more work is needed to ensure that such processes are carried out as intended.

The goal of the research was to answer the following questions:

1. What does the notion of due diligence mean from the perspective of human rights?
2. How successful have current EU due diligence legislative acts been in achieving their stated goals, especially as they relate to human rights?
3. What lessons can be drawn for future due diligence legislation by the EU?

Below are the main findings of the study.

### **The Nature of Human Rights Due Diligence**

Human rights due diligence was developed as a way to integrate human rights considerations into companies' decision-making processes. The UNGPs did this through combining the notion of due diligence as already used in business, in which it is a means of risk management, with that of international human rights law, in which it is a standard of conduct. This mechanism was meant to ensure that companies carefully study the possible impacts of their activities on human rights and take actions to mitigate the identified risks. By giving businesses much freedom in developing due diligence systems that suit them the best, the UNGPs combined the need to respect human rights with the flexibility desired by companies.

However, this flexible approach, which often lacks precise formulations, has spelled trouble for the implementation of human rights due diligence. Taking a risk-management view of human rights has created confusion about what companies have to do to discharge their responsibility to

respect human rights. Experts have warned that companies might be able to forego punishment or providing redress for human rights violations if they show that they had acted with diligence. At the same time, setting up a strict liability standard for all human rights abuses connected to business operations might also be problematic. This is a challenge that regulators will have to consider as they review the effectiveness of human rights due diligence mechanisms.

An additional challenge connected to the nature of due diligence as a risk management tool is whether companies can balance human rights risks against economic considerations. Risk management in the business sense is aimed at minimising the occurrence of events that could negatively affect corporate interests – however, businesses have traditionally concentrated on maximising profit as their main goal. Thus, if respect for human rights is not defined as one of the company's core values, it is not clear if due diligence can be trusted to be effective. This would require businesses to make upholding human rights a perfect moral duty and regard it as a core part of their corporate interests and values. Given the lack of binding international standards and often differing protections under national legislation, it is unclear whether companies are universally required to make respect for human rights a core value. It remains to be seen if there's appetite for prioritising human rights over economic interests. Clarifying these foundational issues is essential to ensuring the proper functioning of human rights due diligence.

### **The Implementation of EU Due Diligence Legislation**

All three EU laws discussed above are novel ways of strengthening respect for human rights and ensuring sustainable development within the Union and beyond. The Non-Financial Reporting Directive requires mandatory disclosure of non-financial information, including human rights due diligence processes, to increase corporate transparency. Logically, this would lead to investors abandoning companies that disclose little or low-quality information on their internal processes. This should, in turn, incentivise companies to improve their behaviour. However, it is unclear if that has been the case. In fact, as a brief case study of Deutsche Bank and Bank of America demonstrated, being under the scope of the Non-Financial Reporting Directive did not necessarily lead to the disclosure of higher-quality information.

The Timber Regulation, which was developed parallel to the UNGPs, was the first EU legislation enshrining the notion of mandatory due diligence. Its aim is to ensure that no illegally harvested timber reaches the EU market in an effort to ensure better environmental conservation through decreasing the prevalence of illegal logging worldwide. While this legislation does not expressly mandate human rights due diligence, it does have implications for the protection of

human rights under domestic laws of the countries of origin and transit. The drafting process of the Regulation showed that due diligence was perceived as a middle-of-the-road solution striking a fair balance between setting stringent rules and flexibility. The Regulation also positioned the EU as a leader in sustainable development and the protection of forests.

The Conflict Minerals Regulation was the first EU legislation requiring human rights due diligence in express terms. The legislation essentially turns a voluntary guidance by the Organisation for Economic Co-operation and Development (OECD) outlining due diligence requirements for the exploitation and trade of certain minerals into binding rules for EU importers. This sectoral due diligence requirement aims to break the link between the exploitation of minerals and armed conflict. The political negotiations leading to the adoption of the Regulation showed the importance of EU lawmakers and civil society actors in strengthening the legislation's provisions to include mandatory due diligence. While the legislation is set to come fully into effect only in 2021, a comparison to its US counterpart, Section 1502 of the 2010 Dodd-Frank Act, signals that the EU Regulation's global reach is set to make it more effective than the US law, which was limited in its regional scope and led to a *de facto* boycott of minerals from a certain region.

Looking at the three EU laws side by side, some patterns concerning the implementation and effectiveness of due diligence emerge. The first issue concerns clarity. In the pieces of legislation that are already fully in force (the Timber Regulation and the Non-Financial Reporting Directive), implementation has been lagging due to confusion by companies on what is required to fulfil requirements in terms of due diligence and reporting on such processes. While both laws define certain basic elements required for due diligence (and disclosing information on it) and also point to several examples and models, this flexible approach seems to be too vague to produce the intended outcomes. It remains to be seen if the Conflict Minerals Regulation, which relies on a more detailed due diligence scheme developed by the OECD, can lead to more success.

The scope of the legislation is another sticking point. Critics have voiced dissatisfaction with the parameters specifying the reach of both the Non-Financial Reporting Directive and the Conflict Minerals Regulation. While this is largely a political issue often decided through opaque negotiating processes, it is important to point out that even the strongest legislation can be rendered ineffective by putting severe limitations on its scope. The issue here relating to due diligence is striking a fair balance between imposing adequate due care requirements, while at the same time not overburdening companies, especially small and medium-sized enterprises. With the growing use of due diligence, the hope is that as such mechanisms become part of business operations, their use will become more routine and less burdensome.



Closing loopholes in due diligence legislation is also essential to making them more effective. This is especially clear from the implementation of the Timber Regulation, where investigations by civil society organisations have shown, for example, that official papers issued in countries of origin can be highly fraudulent, derailing the whole due diligence process. Ending such violations requires multi-layer vigilance on part of the EU and national authorities. Companies also need to be committed to carrying out their due care processes diligently and be willing to sever business relations if suspicions of wrongdoing emerge.

Implementation and enforcement by EU member states are also important elements required for due diligence legislation to be effective. First, national transposition (when applicable) needs to be uniform to avoid creating an uneven playing field, which is the aim of the EU legislation to begin with. Additionally, national authorities need to ensure strong and even enforcement of the laws. The implementation of the Timber Regulation got off to a slow start as a result of uneven enforcement by EU national governments partly due to a lack of technical capacity and resources allocated to authorities. This does not in and of itself invalidate the legislation, however, this is important to keep in mind when developing further similar measures.

It is also important to note that EU laws seek to establish minimum standards. Given the move on the international level towards establishing mandatory human rights due diligence as an obligation of states parties to UN human rights treaties,<sup>359</sup> the level of protection might, in fact, be higher in individual EU member states. Nevertheless, EU-level action – especially when enforced uniformly – can foster the increase of protections both within the Union and outside, given the EU’s important role in global trade.

## **Recommendations Concerning Future Measures**

As the European Commission is in the process of assessing the feasibility of introducing mandatory supply chain due diligence for EU companies, there are some takeaways from the above analysis that could be useful to take into account. Given the complex nature of global supply chains, the scope of the companies covered needs to be carefully considered. Requirements should apply to a large enough group of companies to ensure maximum positive impact and fair competition. At the same time, the limitations of small companies need to be taken into account. Enforcement also needs to be realistically assessed, considering the resources required for competent authorities to ensure the uniform and effective implementation of new measures. Additionally, any legislation

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359 Committee on Economic, Social and Cultural Rights, ‘General Comment No 24 (2017) on State Obligations under the International Covenant on Economic, Social and Cultural Rights in the Context of Business Activities’ (10 August 2017) E/C12/GC/24.

needs to include adequate penalties for non-compliance and ensure appropriate grievance mechanisms for victims.

The extraterritorial scope included in a possible legislation on supply chain due diligence will also need to be carefully considered. As the implementation of the Timber Regulation has shown, assessing risks in far-away countries – especially when companies might not have the resources to carry out checks on the ground – can be highly challenging. This will be even more pronounced in a legislation on supply chain due diligence, which might involve the need for checking large numbers of suppliers throughout the world. Additionally, like in the case of the Conflict Minerals Regulation, which requires the European Commission to issue guidance on a non-exhaustive list of conflict-affected and high-risk areas, the EU should examine the feasibility of issuing similar guidelines to help companies discern salient risks applying to their specific sector in individual countries. Such guidance, which can be a costly and politically divisive exercise, would require increased capacities by the EU in order to carry out careful analyses of third countries.

Civil society organisations supporting the development of mandatory supply chain due diligence legislation see the ongoing discussion over the issue as an unprecedented window of opportunity. Not only is the European Commission assessing the feasibility of such legislation, there's also growing momentum behind the idea from EU member states (such as Germany, Luxembourg, Finland and Italy), civil society and even companies, said Adriana Espinosa, Policy Officer with the European Coalition for Corporate Justice.<sup>360</sup> 'The EU has a chance to really take this front runner's role, knowing what weight the EU has in the global economy,' she said. 'But if they miss this opportunity that would be a shame – it would be seen as a wasted opportunity.'<sup>361</sup> However, for such legislation to be successful, it would need to involve a strong enforcement regime and establish corporate liability to ensure access to remedy for victims.

Besides establishing mandatory supply chain due diligence, there are other steps the EU can take to strengthen its record on business and human rights. Given the confusion some companies currently under EU due diligence obligations still have, the EU could consider establishing a framework to clarify what elements are required to carry out meaningful due diligence. This opinion is shared by experts looking at EU-level action from a UN perspective. 'Developing regulatory standards at the multilateral level on due diligence based on the UN Guiding Principles framework could help,' a UN official said, speaking on the condition of anonymity. 'If the EU were to take up the task of standardising a framework on due diligence, that would be good.'<sup>362</sup> This

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<sup>360</sup> Phone Interview with Adriana Espinosa, Policy Officer, European Coalition for Corporate Justice (Poznan, Poland, 28 June 2019).

<sup>361</sup> Ibid.

<sup>362</sup> Phone Interview with UN Official (conducted on the condition of anonymity) (Poznan, Poland, 22 May 2019 and 28 June 2019).

framework could reaffirm the steps outlined by the UNGPs, setting minimum standards for effective due diligence. Of course, the balance here would still need to be kept to allow for enough flexibility. Espinosa warned against simply creating a list of required actions because it could easily be turned into a ‘box-ticking exercise’, which would defeat the purpose of due diligence.<sup>363</sup>

Finally, the notion underlying human rights due diligence and promoting sustainable finance is inducing a shift in companies’ mindset to look to long-term interests instead of immediate profit-seeking. In fact, the European Commission is assessing whether there is a need to redefine what corporate interests entail.<sup>364</sup> Human rights due diligence is the first step towards this shift by putting human rights considerations into the risk-management process. This is meant to move the company away from shareholder value maximisation, said a European Commission official. The official noted:

If the company’s interest is broader, meaning, yes, of course, you should make a profit, but within the boundaries ... of what is allowed in terms of environment, human rights, climate, and so on, then sure, you will maximise your profit but within the sustainability boundaries.<sup>365</sup>

Whether this shift truly happens remains to be seen. However, it is clear that there’s growing momentum behind rethinking the way the global markets operate, in which the EU has a chance to be the leading voice for a more equitable and human-rights-based system.

The main hypotheses of the present study were that defining human rights due diligence processes needed to be more precise to ensure effective implementation, and that the success of future EU-level due diligence requirements would be dependent on the Union’s willingness to clearly lay down what human rights due diligence should look like and ensure effective implementation of any new rules. These hypotheses seem to have been confirmed by the above study.

The European project is a one-of-a-kind endeavour meant to enhance the lives of not just Europeans but people around the world. As one of the world’s most important trading partners, the EU has a unique opportunity to impact change on business practices throughout the world. With the use of human rights due diligence, the way business operations are carried out might be transformed to put the well-being of people at the centre. If the EU has the political will, it can become a world-

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363 Espinosa (n 360).

364 Phone Interview with European Commission Official (conducted on the condition of anonymity) (Poznan, Poland, 21 June 2019).

365 Ibid.

leader on business and human rights ensuring that business practices do not harm but bring flourishing to people globally.

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