THE UNIVERSITY of ADELAIDE

Modes of Due Diligence Legislation: Lessons from Oceania, North America, and Europe

Research Brief

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make history.

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Introduction

Due diligence in relation to human rights protection in supply chains is increasingly being legislated in developed economies. An important consideration for policy makers' when designing supply chain due diligence legislation is which regulatory approach to take. This analysis considers approaches taken in the Oceania, North American and European contexts. The first is the 'reporting mechanism' approach, in which targeted firms are obligated to produce reports in accordance with prescribed regulations. The second is the 'import control' mechanism, which generally utilises pre-existing legislation to create *de facto* due diligence requirements through prohibiting the importation of goods produced with the use of offending processes. Finally, there is the 'prescribed conduct' mechanism, which either prescribes how an entity is to undertake due diligence or what course of action is to be taken when faced with anticipated or realised human rights issues.

The 'Reporting' Mechanism

The reporting mechanism approach is evident in all jurisdictions we analysed. In North America, this is seen in the *California Transparency in Supply Chains Act* in the United States and the *Fighting Against Forced Labour and Child Labour in Supply Chains Act* in Canada. Within the Oceania context this approach, and due diligence regulation of supply chains more generally, is only to be found Australia's *Modern Slavery Act* 2018 (Commonwealth) and *Modern Slavery Act* 2018 (NSW). In Europe, the reporting mechanism exists within the United Kingdom's *Modern Slavery Act (2015)* and France's *Duty of Vigilance Law (2017)*.

There are three considerations when designing a reporting mechanism. First, what type of entity should report? Second, what should an entity report? Third, what happens should an entity fail to meet its reporting obligations? Analysis of the aforementioned legislation reveals that there many ways to go about answering these questions.

What Type of Entity Should Report?

Another way of framing this question is to ask what the relevant threshold to trigger the reporting obligation is? From a binary perspective, there are essentially two choices: all entities or certain entities. All jurisdictions analysed take the certain entity approach, although the scope varies.

In Canada, pursuant to section 9 of the *Fighting Against Forced Labour and Child Labour in Supply Chains Act,* entities obliged to produce reports include those:

> (a) producing, selling or distributing goods in Canada or elsewhere;
> (b) importing into Canada goods produced outside Canada; or
> (c) controlling an entity engaged in any activity described in paragraph (a) or (b).

In California, pursuant to section 1714.43 (a)(1) of the *California Transparency in Supply Chains Act* reporting obligations are owed by:

> Every retail seller and manufacturer doing business in this state and having an annual worldwide gross receipts that exceed one hundred million dollars ($100,000,000) …

The terms “retail seller”, “manufacturer”, “worldwide gross receipts” and “doing business in this state” are defined with reference to the *Revenue and Taxation Code*.

In Australia, Pursuant to section 5(1) of the *Modern Slavery Act 2018* (Cth), a reporting entity is defined as:

> (a) an entity which has a consolidated revenue of at least $100 million for the reporting period, if the entity:
> (i) is an Australian entity at any time in that reporting period; or
> (ii) carries on business in Australia at any time in that reporting period;
> (b) the Commonwealth;
> (c) a corporate Commonwealth entity, or Commonwealth company, within the meaning of the *Public Governance, Performance and Accountability Act 2013*, which has a consolidated revenue of at least $100 million for the reporting period;
> (d) an entity which has volunteered to comply with the requirement of this Act under section 6 for that period.

In the United Kingdom, pursuant to section 54 of the *Modern Slavery Act* 2015, an entity is obligated to produce a “slavery and human trafficking” statement each financial year if they are a “commercial organisation” and

> (a) supplier of goods or services, and
> (b) has a total turnover of not less than an amount prescribed by regulations made by the Secretary of State.

Current regulations prescribe total turnover at £36 million.[1] The regulations also further define “turnover” to include the turnover of a commercial organisation’s subsidiary undertakings.[2] “Subsidiary undertaking” has the meaning given by Section 1162 of the Companies Act 2006.[3]

For the purposes of producing slavery and human trafficking statements, a “commercial organisation” is defined by section 54(12) as:

> (a) a body corporate (wherever incorporated) which carries on a business, or part of a business, in any part of the United Kingdom, or
> (b) a partnership (wherever formed) which carries on a business, or part of a business, in any part of the United Kingdom.

Subsection 12 goes on to define “business” to include a trade or profession and a “partnership” to be defined with reference to applicable UK legislation or a firm/entity of a similar character formed under the law of a country outside the UK.

In France’s *Duty of Vigilance* Law, a company incurs reporting obligations if it:[4]

> …at the end of two consecutive financial years employs at least five thousand employees within the company and its direct and indirect subsidiaries, whose head office is located on French territory, or at least ten thousand employees within it and in its direct or indirect subsidiaries whose head office is located in France or abroad, establishes and effectively implements a vigilance plan.

In comparing all approaches, it is difficult to determine which has the widest scope as to coverage, given the vagueness of the Canadian legislation. It is not, however, difficult to see which one is the most lenient, being the Californian legislation. That is because it has a high monetary threshold, as well as being applicable to only “retail sellers” and “manufacturers.” These factors suggest that only a handful of entities will fall within the scope of the legislation.

It is important to consider what types of entities should report. This can be seen through the lens of **what they do**. This much is explicit in both the Californian and Canadian contexts. Another lens is to apply **size thresholds**. This is explicit in the Australian, United Kingdom, Californian, and French contexts in which monetary/employee thresholds must first be met.

Considering this distinction an interesting business case observation to be made is how each lens impacts the scope of any reporting mechanism legislation. The necessary consideration that must be made in determining which lens to use is whether one wishes to target a certain industry or all industry. By targeting

[1] The Modern Slavery Act 2015 (Transparency in Supply Chains) Regulations 2015, reg 2.
[2] Ibid reg 3(1).
[3] Ibid reg 1(2)(b).
[4] Article L225-102-4.

all industry, one may be more effective at combatting modern slavery everywhere, at the expense of burdening some entities that have a near zero chance of modern slavery risks. Alternatively, by targeting a specific industry, one may be effective in combatting modern slavery in troublesome industries and avoiding burdening non-troublesome industries, at the risk of allowing some degree of modern slavery to persist.

What Should An Entity Report?

The Canadian and Australian regimes overlap when it comes to what they should report. In Canada's *Fighting Against Forced Labour and Child Labour in Supply Chains Act*, a reporting entity is obligated to report:

> …to the Minister on the steps the entity has taken during its previous financial year to prevent and reduce the risk that forced labour or child labour is used at any step of the production of goods in Canada or elsewhere by the entity or of goods imported into Canada by the entity.[5]

In addition an entity's report must include the following information:[6]

> (a) Its, structure, activities and supply chains;
> (b) its policies and its due diligence processes in relation to forced labour and child labour;
> (c) the parts of its business and supply chains that carry a risk of forced labour or child labour being used and the steps it has taken to assess and manage that risk;
> (d) any measures taken to remediate any forced labour or child labour;
> (e) any measures taken to remediate the loss of income to the most vulnerable families that results from any measure taken to eliminate the use of forced labour or child labour in its activities and supply chains;
> (f) the training provided to employees on forced labour and child labour; and
> (g) how the entity assesses its effectiveness in ensuring that forced labour and child labour are not being used in its business and supply chains.

The Australian *Modern Slavery Act* 2018 (Cth) reporting mechanism contains similar requirements. Pursuant to the Act a report, known as a modern slavery statement, must:[7]

> (a) identify the reporting entity; and
> (b) describe the structure, operations and supply chains of the reporting entity; and
> (c) describe the risks of modern slavery practices in the operations and supply chains of the reporting entity, and any entities that the reporting entity owns or controls; and
> (d) describe the actions taken by the reporting entity and any entity that the reporting entity owns or controls, or assess and address those risks, include due diligence and remediations processes; and
> (e) describe how the reporting entity assesses the effectiveness of such action; and
> (f) describe the process of consultation with:
>
> (i) any entities that the reporting entity owns or controls; and
>
> (ii) in the case of a reporting entity covered under section 14 – the entity giving the statement: and
>
> (g) include any other information that the reporting entity, or the entity giving the statement, considers relevant.

[5] Section 11(1)
[6] Section 11(3)
[7] Section 16(1).

One difference is that the "duty of care" to consult and train affected employees, as required in the Canadian legislation, is not present in the Australian case.

There is also a general similarity between the Australian, Canadian, and United Kingdom regimes. Given the United Kingdom legislation pre-dates both its Australian and Canadian counterparts, its influence can be readily seen in the latter two regimes. In the United Kingdom commercial organisations, so defined, are to produce slavery and human trafficking statements to include at a bare minimum:[8]

> (a) a statement on the steps the organisation has taken during the financial year to ensure that slavery and human trafficking is not taking place –
>
> (i) in any of its supply chains, and
>
> (ii) in any part of its business, or
>
> (b) a statement that the organisation has taken no such steps.

Such statements may, but are not obligated to, include information about:[9]

> (a) the organisation's structure, its business and its supply chains;
> (b) its policies in relation to slavery and human trafficking;
> (c) its due diligence processes in relation to slavery and human trafficking in its business and supply chains;
> (d) the parts of its business and supply chains where there is a risk of slavery and human trafficking taking place, and the steps it has taken to assess and manage that risk;
> (e) its effectiveness in ensuring that slavery and human trafficking is not taking place in its business or supply chains, measured against such performance indicators as it considers appropriate;
> (f) the training about slavery and human trafficking available to its staff.

The Californian approach differs substantially in the greater level of detail required. In accordance with its reporting obligations, an entity is obligated to disclose to what extent it does the following:[10]

> (1) Engages in verification of product supply chains to evaluate and address risks of human trafficking and slavery. The disclosure shall specify if the verification was not conducted by a third party.
> (2) Conducts audits of suppliers to evaluate supplier compliance with company standards for trafficking and slavery in supply chains. The disclosure shall specify if the verification was not an independent, unannounced audit.
> (3) Requires direct suppliers to certify that materials incorporated into the product comply with the laws regarding slavery and human trafficking of the country or countries in which they are doing business.
> (4) Maintains internal accountability standards and procedures for employees or contractors failing to meet company standards regarding slavery and trafficking.
> (5) Provides company employees and management, who have direct responsibility for supply chain management, training on human trafficking and slavery, particularly with respect to mitigating risks within the supply chains of products.

The French Vigilance Law is another outlier that imposes quasi-reporting requirements in which companies are to produce "vigilance plans." These plans are to be generally designed to include:[11]

> …reasonable vigilance measures to identify the risks and prevent serious violations of human rights and fundamental freedoms, the health and safety of people and the environment, resulting from the activities of the company and those it controls…as well as the activities of subcontractors or suppliers with whom an established commercial relationship is maintained…"

More specifically, such plans are to include:

> 1. A mapping of risks intended for their identification, analysis and prioritization;
> 2. Procedures for regular assessment of the situation of subsidiaries, subcontractors or suppliers with whom an established commercial relationship is maintained, with regard to risk mapping;
> 3. Appropriate actions to mitigate risks or prevent serious harm;
> 4. An alert mechanism and collection of reports relating to the existence of occurrence of risks, established in consultation with the representative trade unions in the said company;

[8] Section 54(4).
[9] Section 54(5).
[10] Section 1714.43 (c).
[11] Article L225-102-4 Commercial Code

5. A system for monitoring the measures implemented and evaluating their effectiveness.

The plans, including the report on their effectiveness, are to be made public and included in the management report tabled at each company's yearly ordinary general meeting.

The Australian/Canadian/United Kingdom approach asks entities to report on topics of a general nature, while the Californian approach is more specific. This is interesting from an outcome perspective, as these differing approaches may have different outcomes in terms of how entities go about conducting due diligence. The specificity of the Californian approach creates an enticement for entities to conduct due diligence in accordance with what they are expected to report about, namely, conduct audits and require certifications of suppliers. Contrasted with the more general nature of the Australian/Canadian approach which leaves it to the entity to decide what constitutes best practice for due diligence by asking it to report on what it is actually doing, not on certain things it may or may not be doing. The French reporting obligations are different again, where they are to produce a plan to combat human rights risks and report on that plan's effectiveness rather than the broad approach taken in other jurisdictions.

Failure to Meet Reporting Obligations?

Once it has been determined what types of entities should provide a report and what information should be provided, it is then important to determine what should happen if an entity fails to meet these reporting obligations. Each jurisdiction takes a different approach to this question with punishments varying in degree of severity. On the lessor end of the spectrum, in which severity is seen through the lens of tangible punishment, lays the Australian approach. On the other end, in which punishment is the most severe, lay the French and Canadian approaches with the Californian/United Kingdom approach laying somewhere in between.

The Australian Approach: Name and Shame

The Australian approach is to 'name and shame'. Section 16A of the *Modern Slavery Act* 2018 (Cth)[12], contains the process for this. First the relevant Minister, being the Attorney-General, if reasonably satisfied that a reporting entity has not fulfilled their obligations, may either ask for explanation for the failure to comply or request that the failing entity undertake specified remedial action in relation to the failed obligation.[13] Should the entity fail to remedy the situation, the Minister is permitted to publish the following information on the Modern Slavery Register ("name and shame"):

(a) the identity of the entity;
(b) if the request relates to the entity's failure to comply with subsection 14(2) (joint modern slavery statements) in relation to a modern slavery statement—the identities of the reporting entities covered by the statement;
(c) the date the request was given, and details of any extension given under subsection (2);
(d) details of the explanation or remedial action requested, and the period or periods specified in the request.
(e) The reasons why the Minister is satisfied that the entity has failed to comply with the request.

The intended punishment for failure is public scrutiny/pressure. The objective, clearly, is by making these failures public consumers will be able to make informed decisions about the products they purchase. Given

[12] It is important to note the *Modern Slavery Act* has been the subject of a review by the Attorney-General's Department with a report being released in May 2023. Some of the recommendations by the report propose significant changes as to how the Act is to operate. Specifically, proposed changes to threshold requirements and the introduction of penalty provisions. Currently, no legislation has been introduced to implement these recommendations, except for the establishment of an "Anti-Slavery Commissioner" in accordance with Recommendation 1. As such, this analysis is subject to change.
[13] Section 16A(1).

the proclivity of developed nations' consumers to make choices based upon human and labour rights considerations, the publication of information suggesting an entity is complicit in human or labour rights violations will have an impact upon a consumer's decision to purchase their product. This, therefore, incentivises entities to take the due diligence obligations seriously, and produce reports that accurately identify and address risks in their supply chains, so they may be perceived by consumers as ethical.

The Californian and United Kingdom Approach: Injunctive Relief

The Californian approach is one of injunctive relief. Pursuant to section 1714.43 (d):

> The exclusive remedy for a violation of this section shall be an action brought by the Attorney General for injunctive relief. Nothing in this section shall limit remedies available for a violation of any other state or federal law.

An injunctive relief is a remedy sought, by order of a court, to compel someone to engage in, or refrain from, a certain type of action. Parties who violate an injunctive order are exposed to criminal or civil contempt of court proceedings with associated sanctions. As such, should a Californian entity fail in its reporting obligations, the California Attorney General may bring action to compel compliance.

It is necessary to note the final sentence of section 1714.43 (d) in which the section is not to be interpreted in a way that limits other available remedies. This would suggest that there may be other remedies available if an entity fails to report in relation to other state and federal laws. Without a working knowledge of Californian law it is difficult, however, to determine what these remedies may be.

Similarly in the United Kingdom, Section 54(11) of the *Modern Slavery Act* 2015 allows for the Secretary of State to:

> [bring] civil proceedings in the High Court for an injunction or, in Scotland, for specific performance of a statutory duty under section 45 of the Court of Session Act 1988.

The Canadian Approach: Offences and Punishments

Unlike the two explored above, the Canadian approach has a more tangible mechanism for failure. The *Fighting Against Forced Labour and Child Labour in Supply Chains Act* creates two types of offences: Those relating to the report itself, and offences relating to the information within the report.

Of the offences relating to the report itself, section 19(1) makes it an offence to either not produce a report or to not publish a report on the entity's website. If the entity or person in question is part of a federal corporation, then it is a further offence to not provide the report to shareholders. In any event, the failure is an offence punishable on summary conviction and attracts a fine of no more than CAD 250,000.

Of the offences relating to the information contained within the report, section 19(2) makes its an offence to knowingly make false or misleading statements or provide false or misleading information. This offence is also punishable on summary conviction and attracts a fine of no more than CAD 250,000.

It is important to note that severity is not just related to the punishment itself, but to the scope of persons to which punishment can be applied. In accordance with section 20:

> If a person or an entity commits an offence under this Part, any director, officer or agent or mandatory of the person or entity who directed, authorized, assented to, acquiesced in or participated in its commission is a party to and guilty of the offence and liable on conviction to the punishment provided for the offence, whether or not the person or entity has been prosecuted or convicted.

The wording of this clause clearly creates a chain of responsibility in which involved persons can be held vicariously liable for the report and its information. The clear intent being to prevent corporate scapegoating in which those higher in the corporate hierarchy could avoid punishment by blaming their delegates.

The French Approach: Civil Liability

The French *Vigilance Law* demonstrates another tangible mechanism for failure. Under Article L. 225-102-5, a breach of the obligations defined in Article L. 225-102-4:

> …engages the responsibility of its author and obliges him to repair the damage that the execution of these obligations would have avoided.

Bringing an action for damages must be brought:

> …before the competent court by any person justifying an interest in acting for this purpose.

It appears within French jurisprudence that no successful cases against a company have been pursued on these grounds. A recent case involving Total Energies was dismissed in a French court. However, this dismissal resulted from a technicality in which the action had been brought in the wrong jurisdiction (not before a competent court) and therefore the merits of the case had not been tested.[14] This fact significantly reduces the analytical value of such a case, given neither the law nor the merits had been properly tested. There are other cases currently before the French Courts, whose resolution may yield more interesting results.

The 'Import Control' Mechanism

The import control mechanism uses customs law to prohibit the importation of products that have been produced using prescribed prohibited processes. In the North American context, this approach is seen within the United States *Uyghur Forced Labor Prevention Act* and the *Tariffs Act of 1930*. It is also seen within the Canadian *Fighting Against Forced Labour and Child Labour in Supply Chains Act*. In the Oceania context the mechanism does not exist but could theoretically exist pursuant to the *Customs Act 1901* (Cth).

An interesting component of the import control mechanism is the fact it uses often long standing customs legislation that was never explicitly designed to regulate supply chain due diligence. What it does, however, is create de facto due diligence obligations in the sense that an importing entity must ensure that the good they are importing has not been produced with the prohibited process, lest that good be confiscated or otherwise disposed of in accordance with the relevant rules. While it does not require due diligence in theory, the import control mechanism requires it in practice if an entity wishes to consistently import its product without interference from customs officials.

Whereas the reporting mechanism, depending on self-imposed limitations, can theoretically apply to all entities within a nation's jurisdiction the import control mechanism only applies to those entities that import products. While in practise there might not be a large divide between the number of entities each approach covers, it is nonetheless important to recognise that gaps may occur in each respective approach.

When considering using the import control mechanism, there are two questions to ask: 1) what type of processes should be prohibited, and 2) should the controls be global or specific to a geographic target? As with the reporting mechanism, there is a degree of both similarity and difference taken by each jurisdiction when answering each question.

[14] https://www.morganlewis.com/pubs/2023/04/french-interim-civil-judge-dismisses-duty-of-vigilance-case-brought-by-ngos-against-total-energies

What Type of Processes Should be Prohibited?

There is relative convergence on the types of processes that should be subject to import controls. Both the US *Tariffs Act of 1930* and the Canadian *Fighting Against Forced Labour and Child Labour in Supply Chains Act* prohibit the importation of goods produced by forced or child labour. However, they differ on how forced and child labour is to be defined. Section 1307 of the *Tariffs Act of 1930* defines forced labour in the following way:

> "Forced Labor", as herein used, shall mean all work or service which is exacted from any person under the menace of any penalty for its non performance and for which the worker does not offer himself voluntarily.

It further goes on to say:

> For the purpose of this section, the term "forced labor or/and indentured labor" includes forced or indentured child labor.

Contrast this with the Canadian *Fighting Against Forced Labour and Child Labour in Supply Chains Act*, which more specifically defines forced and child labour as:[15]

> ***Child labour*** means labour or services provided or offered to be provided by persons under the age of 18 years and that
>
> (a) are provided or offered to be provided in Canada under circumstances that are contrary to the laws applicable in Canada;
>
> (b) are provided or offered to be provided under circumstances that are mentally, physically, socially or morally dangerous to them;
>
> (c) interfere with their schooling by depriving them of the opportunity to attend school, obliging them to leave school prematurely or requiring them to attempt to combine school attendance with excessively long and heavy work; or
>
> (d) constitute the worst forms of child labour as defined in article 3 of the Worst Forms of Child Labour Convention, 1999, adopted at Geneva on June 17, 1999. (*travail des enfants*)
>
> ……
>
> **Forced labour** means labour or service provided or offered to be provided by a person under circumstances that
>
> (a) could reasonably be expected to cause the person to believe their safety or the safety of a person known to them would be threatened if they failed to provide or offer to provide the labour or service; or
> (b) constitute forced or compulsory labour as defined in article 2 of the Forced Labour Convention, 1930, adopted in Geneva on June 28, 1930. (*travail forcé*)

Upon comparing to two definitions, it is clear that the Canadian definition is wider than its United States counterpart. There is relative agreement on the definition of forced labour, as the United States definition uses the exact same wording as the *Forced Labour Convention* referenced in the Canadian Act. However, there are differences when defining child labour. The United States defines it in the same terms as forced labour, whereas Canada takes a broader approach and incorporates additional factors such as impact upon schooling and mentally, physically, socially, or morally dangerous circumstances.

Naturally, the definition used is important as it defines the scope of products that may be prohibited. Taking a too narrow approach is likely to lead to legal importation of products, despite their ethically dubious production methods. On the other hand, taking a wide approach can result in the prohibition of a significant number of imports, which has its own associated challenges.

Within the Australian context, section 50 of the *Customs Act 1901* (Cth) permits the Governor-General, by way of regulation, to prohibit the importation of goods in specified circumstances.[16] This provision would allow the Governor-General to prohibit the importation of goods produced through forced or child labour,

[15] Section 2.
[16] Section 50(2)(aa).

however defined. However, current regulations, as codified in the Customs (Prohibited Imports) Regulations 1956 do not prohibit imports based on child/forced labour, or otherwise like grounds.

Global v Geographic Application

Generally, an import control mechanism will apply globally, as is the case with the US *Tariffs Act of 1930* and the Canadian *Fighting Against Forced Labour and Child Labour in Supply Chains Act*. The rationale being that forced/child labour occurs globally, therefore it makes most sense to regulate globally.

However, in the United States geographic approaches do exist through the *Uyghur Forced Labour Prevention Act*. Pursuant to section 3, the *Uyghur Forced Labour Prevention Act* creates a rebuttable presumption that imports are to be prohibited with respect to:

> "…goods, wares, articles and merchandise mined, produced, or manufactured wholly or in part in the Xinjiang Uyghur Autonomous Region in the People's Republic of China…"

As such, unless an importer can prove otherwise, products from that specific location are prohibited based on the presumption that they have been produced using processes in accordance with section 1307 of the *Tariff Act of 1930*.[17]

The potential for this approach also exists in the Australian context. Pursuant to section 50(2)(b) of the *Customs Act 1901* (Cth), the Governor-General is permitted to prohibit the importation of goods from a specified place. In fact, pursuant to the Customs (Prohibited Imports) Regulations 1956, imports of certain goods are prohibited from the Democratic People's Republic of Korea, Iran, Eritrea, and Libyan Arab Jamahiriya. However, it is important to note that these geographic provisions targeted the trade of arms and paramilitary equipment, and other associated equipment, not products produced with forced/child labour. However, there is no reason to suspect that such measures could not be used to target such processes. Interestingly, given such laws are produced by the Governor-General who acts on advice from the government, such changes would not necessarily be burdensome from a legislative perspective.

The 'Prescribed Conduct' Mechanism

Analysis of European legislation yields yet another approach to due diligence that operates in tandem with the "reporting" and "import control" mechanisms. We label this the "proscribed conduct" mechanism, with legislation from Europe being arguably more interventionist vis-à-vis their Oceanic counterparts in particular.

From an analysis of select European due diligence legislation, there are two ways in which the proscribed conduct mechanism can manifest. This primarily turns on what the legislation intends to proscribe. First, through legislation proscribing how a company undertakes due diligence. This naturally differs from the Oceanic approach where due diligence practice is left largely for firms to decide, guided only by broad reporting criteria and a consumer expectation of thorough investigation to merit legitimacy. Second, through legislation prescribing what measures a company must undertake when faced with anticipated or actual human/labour rights issues identified through their due diligence processes. This concept is entirely foreign to the Oceanic experience, which prescribes no such obligations.

[17] Section 3(a)(1).

Prescribing How to Undertake Due Diligence

Norway's Transparency Act

Under the Norwegian *Act relating to enterprises' transparency and work on fundamental human rights and decent working conditions ('Transparency Act')*, pursuant to section 4, regulated enterprises have a duty to carry out due diligence and that;

> "the enterprises shall carry out due diligence in accordance with the OECD Guidelines for Multinational Enterprises. For the purposes of this Act, due diligence means to
>
> a) Embed responsible business conduct into the enterprise's policies
> b) Identify and assess actual and potential adverse impacts on fundamental human rights and decent working conditions that the enterprise has either caused or contributed toward, or that are directly linked with the enterprise's operations, products or services via that supply chain or business partners.
> c) Implement suitable measures to cease, prevent or mitigate adverse impacts based on the enterprise's prioritisations and assessments pursuant to (b)
> d) Track the implementation and results of measures pursuant to (c)
> e) Communicate with affected stakeholders and rights-holders regarding how adverse impacts are addressed pursuant to (c) and (d)
> f) Provide for or co-operate in remediations and compensation where this is required…"

What the *Transparency Act* clearly does is prescribe the approach in which its regulated enterprises are to undertake due diligence legislation. It prescribes both the scope of due diligence conduct, through its understanding of what due diligence means for the purposes of the act, and the method in which it is to be undertaken through its reference to the OECD Guidelines for Multinational Enterprises.

For example, if an enterprise wished to comply with their duty under section 4(c), the OECD guidelines recommend that they either alone, or in co-operation with other enterprises, seek to leverage their influence over the offending entity to prevent or mitigate their adverse human rights practices. Determining the appropriate course of action in leveraging this influence, the OECD advises that, among other factors, the enterprise will consider the strength of their leverage over the entity concerned, how crucial the relationship is to the enterprise, the severity of the impact, and whether terminating the relationship with the entity itself would have adverse human rights impacts.[18]

Alternatively, if an enterprise concludes that they do not possess the leverage necessary to directly change an offending entities' behaviour, they can increase their influence through support, training, and capacity building. They can also influence their business partners through engagement to urge change, building expectation around responsible business conduct, and specified contractual arrangements.[19]

Netherlands' Child Labor Due Diligence Act

The Netherlands' Child Labor Due Diligence Act also prescribes the way regulated entities are to undertake due diligence. Compared with its Norwegian counterpart, the Netherlands regime is more basic and does not refer to OECD guidelines. Pursuant to Article 5(1), a company exercises their due diligence obligations when they conduct investigations where:[20]

> …there is a reasonable suspicion that the goods or services to be supplied have been created with the help of child labor and that, in the event of a reasonable suspicion, draws up a plan of action.

[18] Para 48, OECD Guidelines for Multinational Enterprises on Responsible Business Conduct, pg 26.
[19] Para 23, OECD Guidelines for Multinational Enterprises on Responsible Business Conduct, pg 19. These contractual arrangements can include management contracts, pre-qualification requirements, voting trusts, and license or franchise agreements.
[20] Article 5(1)

This investigation and plan of action are largely left up to each company to decide. However, Article 5(3), allows:

> By or pursuant to order in council[21], with due observance of the ILO-IOE Child Labor Guidance Tool for Business, further requirements are set for the investigation and for the action plan referred to in the first paragraph.

The investigation itself is further tempered by operation of Article 5(3) in which:

> The investigation referred to in the first paragraph is aimed at sources that are reasonably known and accessible to the company.

Prescribing Conduct When faced with Human Rights Issues

Germany's Act on Corporate Due Diligence

Section 7 of the *Corporate Due Diligence Act* prescribes the remedial action that an enterprise is to undertake when faced with a human rights related issue in their supply chains. Generally, pursuant to section 7(1), German corporations are obligated to:

> "…without undue delay, take appropriate remedial action to prevent, end or minimise the extent of this [human rights-related] violation."

However, should the violation in question be of such a nature that the enterprise cannot end it in the foreseeable future, Section 7(2) provides a more prescribed course of action in which enterprises are to:

> "…draw up and implement a concept for ending or minimising the violation without undue delay. The concept must contain a concrete timetable. When drawing up and implementing the concept, the following measures in particular must be taken into account.
>
> 1. The joint development and implementation of a plan to end or minimise the violation with the enterprise causing the violation,
> 2. Joining forces with other enterprises in sector initiatives and sector standards to increase the ability of influencing the entity that causes or may cause a harm.
> 3. A temporary suspension of the business relationship while efforts are being made to minimise the risk."

Further, in the more extreme event, Section 3 obliges German corporations to terminate their business relationship with an offending enterprise if:

> 1. The violation of a protected legal position[22] or an environmental-related obligation is assessed as very serious[23],
> 2. The implementation of the measures developed in the concept does not remedy the situation after the time specified in the concept has elapsed,
> 3. The enterprise has no other less severe means at its disposal and increasing the ability to exert influence has no prospect of success.

Interestingly, it is not clear on initial reading as to whether a termination obligation arises if one or all of the conditions have been met. Grammatically, the use of commas suggest that all conditions must be met. However, there is reason to believe that each condition can be fulfilled without need for the others and therefore only one is needed for the obligation to arise.

In any event, there is one caveat to section 3. This caveat states that the obligation to terminate the business relationship does not arise from the mere fact that a State in which the offending entity is based

[21] Also known as 'Ministerial Regulations', which are laws issued by a Minister or State Secretary. See http://dutchcivillaw.com/content/legalordercontent011.html.

[22] Arising from the Convention on the Protection of Human Rights.
[23] 'Very serious' is not defined in the legislation.

has not ratified one of the Conventions listed in the Annex of the legislation or has not implemented it into its national law.[24]

The Act also prescribes action for enterprises to undertake preventive measures in accordance with section 6. Section 6(1) states:

> "if an enterprise identifies a risk in the course of a risk analysis pursuant to section 5, it must take appropriate preventive measures pursuant to paragraphs (2) to (4) without undue delay."

Paragraph (2) obligates enterprises to issue policy statements on their human rights strategies, and that these strategies be adopted by senior management. The statement must contain at least the following:

> "1. The description of the procedure by which the enterprise fulfills its obligations under section 4(1), section 5(1), section 6(3) to (5), and sections 7 to 10."
>
> 2. the enterprise's priority human rights and environmental-related risks identified on the basis of the risk analysis and
>
> 3. the definition, based on the risk analysis, of the human rights-related and environment-related expectations placed by the enterprise on its employees and suppliers in the supply chain."

Paragraph (3) obligates enterprises to lay down appropriate preventive measures in their own area of business.[25] Specifically, it requires:

> "1. The implementation of the human rights strategy in the relevant business processes set out in the policy statement.
>
> 2. the development and implementation of appropriate procurement strategies and purchasing practices that prevent or minimize identified risks.
>
> 3. the delivery of training in the relevant business area.
>
> 4. the implementation of risk-based control measures to verify compliance with the human rights strategy contained in the policy statement in its own business area."

Paragraph (4) obligates enterprises to lay down appropriate preventative measures vis-à-vis its direct suppliers. Specifically, it requires:

> "1. The consideration of human rights-related and environment-related expectations when selecting a direct supplier,
>
> 2. contractual assurances from a direct supplier that it will comply with the human rights-related and environmental-related expectation required by the enterprise's senior management and appropriately address them along the supply chain,
>
> 3. the implementation of initial and further training measures to implement the contractual assurances made by the direct supplier according to number 2,
>
> 4. agreeing on appropriate contractual control mechanisms and their risk-based implementation to verify compliance with the human rights strategy at the direct supplier."

As such, what the German *Corporate Due Diligence Act* demonstrates is a unique approach to due diligence in which the law prescribes what action a corporation is to take both in anticipation of identified risks and if those risks are realised. By spelling out what a corporation is expected to do to be seen as conforming to the law, it makes it easier to comply. The positive of such an approach is that its prescriptive nature can reduce costs and, more importantly, the efforts of adhering to due

[24] Given the definition of "protected legal position" being purely based on international standards, the fact the State in which an offending entity may operate does not recognise or protect these rights is irrelevant to the consideration to terminate business ties. It seems the legislation is making an exemption for something that was never going to be considered in the first place.

[25] Defined by section 2(6) as "every activity of the enterprise to achieve the business objective. This includes any activity for the creation and exploitation of products and services, regardless of whether it is carried out at a location in Germany or abroad…".

diligence legislation. Naturally, the time and cost implications additionally turn on how burdensome such expectations may be. It further prevents variance in approaches that a less prescriptive approach would yield, that would see differing levels of success depending on how seriously a corporation took its obligations.

Conversely, prescribing what measures are to be taken runs the risk of being ineffective should the standards so prescribed prove unproductive. It inherently prevents innovation and doesn't allow for corporations to tailor their due diligence response in accordance with their size and industry; a one size fits all approach may lose the nuance required for success.

The European Union's Proposed Directive[26] on Corporate Sustainability Due Diligence

The influence of the German Act can be seen at a supranational level with the EU's *Proposed Directive on Corporate Sustainability Due Diligence*. Articles 7 and 8 seem to implement and build upon the German model, and if introduced will see all EU States having to implement domestic law in accordance.

Article 7 deals with preventing 'potential adverse human rights impacts. Article 7(1) obligates Member States to ensure that companies take appropriate measures to prevent adverse human rights impacts. If this is not possible or not immediately possible, they are to ensure the companies take prescribed actions.

Article 7(2) obligates a Member State to regulate to ensure a company takes the following action, where relevant. [summarised to reduce length]

> (a) Develop and implement a prevention action plan, with defined timelines and qualitative and quantitative indicators for measuring improvement. Shall be developed with consultation with affected stakeholders.
> (b) Seek contractual insurance with those it has a direct business relationship with. As necessary, seek corresponding contractual assurances from its business partner's business partners. (contractual cascading)
> (c) Make investments, such as into management or production processes and infrastructure, to mitigate or prevent adverse human rights impacts.
> (d) Provide support for SMEs with which a company has an established business relationship, where compliance with code of conduct or prevention action plan would jeopardise the viability of the SME.
> (e) Collaborate with other entities, to increase the company's ability to bring adverse impacts to an end. Especially where no other action is suitable or effective. Such collaboration is to be conducted in compliance with Union law, including competition law.

Article 7(3) provides that should the measures outlined above prove ineffective in preventing or adequately mitigating the potential adverse impacts, then the company may seek to conclude a contract with a partner with whom it has an indirect relationship in an attempt to achieve compliance. The rationale behind this Article is to provide upward pressure on a non-complying supplier by getting their suppliers to comply instead.

In any event, should contractual arrangement with the indirect partner also prove fruitless then Article 7(5) operates as a measure of last resort. It obligates companies to:

> "…refrain from entering into new or extending existing relations with the partner in connection with or in the value chain of which the impact has arising and shall, where the law governing their relations so entitle them to, take the following actions:
>
> (a) temporarily suspend commercial relations with the partner in question, while pursuing prevention and minimisation efforts, if there is reasonable expectation that these efforts will succeed in the short-term;
> (b) terminate the business relationship with respect to the activities concerned if the potential adverse impact is severe.

[26] It is important to distinguish between the different types of EU legislation; specifically, the difference between a 'Directive' and a 'Regulation. A Regulation is a binding legislative act that is applied across the entire EU. It operates in accordance with its own text. A Directive is a legislative instrument that sets out the goals that all EU countries must achieve. The method of regulation is left for each state to decide with their own laws. See https://european-union.europa.eu/institutions-law-budget/law/types-legislation_en.

Article 7(5) further obligates Member States to provide for the availability of an option to terminate the business relationship in contracts governed by their laws. Naturally, this prevents legal proceedings for breach of contract as it is unlikely that termination for breach of human rights is recognised at law.

However, the actions stipulated above are different for companies that are either a credit institution, investment firm or alternative fund investment fund manager as defined in Article 3 (a)(iv), as Article 7(6) allows derogation from Article 7(5) should termination be:

> "…reasonably expected to cause substantial prejudice to the entity to whom that service is being provided."

Article 8 moves the focus from anticipated human rights issues towards realised human rights issues. Article 8 operates largely in the exact same way article 7 does. However, it differs in one way; in which the prevention plan prescribed in Article 7(2)(a) has been replaced by the obligation in Article 8(3)(a) for companies to:

> "neutralise the adverse impact or minimise its extent, including by the payment of damages to the affected persons and of financial compensation to the affected communities. The action shall be proportionate to the significance and scale of the adverse impact and to the contribution of the company's conduct to the adverse impact."

Besides this change, the provisions in Article 8 are essentially a rewrite of Article 7 with wording changed to reflect a realised adverse human rights impact rather than an anticipated one.