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THE PROSPECTS AND LIMITATIONS OF HUMAN RIGHTS DUE DILIGENCE LEGISLATION IN EUROPE

I. Introduction

Globalisation has introduced an array of regulatory challenges that demand innovative solutions beyond traditional forms of governance. One particular challenge concerns human rights violation in the context of business activity. Recent examples that hit the headlines are child labour in cobalt mines in the Democratic Republic of the Congo¹ and modern forms of slavery in the fishing industry in Thailand.² Even though there is no comprehensive data to quantify such incidents, the continuity of reported cases indicates a systemic – as opposed to a random – risk of business-related human rights abuses.³ Meanwhile, traditional forms of governance have proven insufficient to address the situation which is commonly described as the *global governance gap*.⁴ Harvard Professor John Ruggie in his capacity as Special Representative of the UN Secretary-General on the issue of human rights and transnational corporations and other business enterprises phrased it as follows:

Clearly, a more fundamental institutional misalignment is present: between the scope and impact of economic forces and actors, on the one hand, and the capacity of societies to manage their adverse consequences, on the other. This misalignment creates the *permissive environment* within which blameworthy acts by corporations may

¹ Amnesty International, 'Time to Recharge: Corporate Action and Inaction to tackle Abuses in the Cobalt Supply Chain' (15 November 2017) <<https://www.amnesty.de/sites/default/files/2017-11/Amnesty-Bericht-Kongo-November2017.pdf>> accessed 12 February 2018; Mark Dummett, 'The Dark Side of Electric Cars: Exploitative Labor Practices' *Time* (28 September 2017) <<http://time.com/4939738/electric-cars-human-rights-congo/>> accessed 27 October 2017.

² Human Rights Watch, 'Hidden Chains: Rights Abuses and Forced Labor in Thailand's Fishing Industry' (23 January 2018) <<https://www.hrw.org/report/2018/01/23/hidden-chains/rights-abuses-and-forced-labor-thailands-fishing-industry>> accessed 12 February 2018.

³ However, there are NGO's running information platforms on business and human rights issues, see in particular Business and Human Rights Resource Centre <<https://www.business-humanrights.org>> accessed 12 November 2018.

⁴ For instance, UN Human Rights Council, 'Protect, Respect and Remedy: a Framework for Business and Human Rights: Report of the Special Representative of the Secretary-General on the issue of human rights and transnational corporations and other business enterprises, John Ruggie' (7 April 2008) UN Doc. No. A/HRC/8/5; A. Crane and others (eds), *Globalization and Corporate Social Responsibility*, in: *The Oxford Handbook of Corporate Social Responsibility* (Andreas Georg Scherer and Guido Palazzo, Oxford University Press 2008); Nadia Bernaz, *Business and human rights: History, law and policy: bridging the accountability gap* (Human rights and international law, Routledge 2017); Penelope Simons and Audrey Macklin, *The Governance Gap: Extractive Industries, Human Rights, and the Home State Advantage* (Routledge Studies in Governance and Change in the Global Era, Taylor and Francis 2014).



occur without adequate sanctioning or reparation. For the sake of the victims of abuse, and to sustain globalization as a positive force, this must be fixed.⁵

Against this backdrop, the question that arises is how to fix the – in Ruggie’s words – *fundamental institutional misalignment*.

Due to the global scope of the problem, a multilateral approach seems to be suited. To date, however, the international legal order has failed to establish an effective governance structure that addresses business-related human rights violations.⁶ Presently, state actors are negotiating a human rights treaty for business enterprises at the UN level.⁷ Lacking support of many Western states, however, the endeavour encounters considerable political hurdles which calls its prospects into question. While missing out on a hard law solution, the continuous multilateral efforts have resulted in several soft law approaches on the issue of business and human rights in recent years. The most important contribution are the United Nations Guiding Principles on Business and Human Rights (UNGPs) from 2011 which define three pillars (‘Protect, Respect and Remedy’) for the protection of human rights in context of business activity.⁸ The first pillar lays down a state duty to protect human rights while the third pillar calls for effective judicial and non-judicial remedy mechanisms. The second pillar, in turn, stipulates a *corporate responsibility to respect human rights* that grounds on the expectations of society towards business actors to contribute to the prevention and termination of human rights abuses.⁹

At the core of the responsibility to respect human rights lies a novel instrument called *human rights due diligence* (in the following referred to as HRDD). The term *due diligence* can also be found in international law, business regulation and practice. Under international law, it forms a standard to assess the compliance of a state with a specific obligation (for example, under international environmental law).¹⁰ In the realm of business regulation, in turn, due diligence serves either as a mandatory benchmark for corporate compliance or

⁵ John Ruggie, ‘Business and human rights: mapping international standards of responsibility and accountability for corporate acts: Report of the Special Representative of the Secretary-General on the issue of human rights and transnational corporations and other business enterprises’ (A/HRC/4/35, 2007), 3 (emphasis added).

⁶ Crane and others (eds) (n 4), 14; Matthias Herdegen, *Principles of international economic law* (Second edition, Oxford University Press 2016), 23.

⁷ UN Human Rights Council, ‘Elaboration of an international legally binding instrument on transnational corporations and other business enterprises with respect to human rights’ (UN Doc. No. A/HRC/RES/26/9, 14 July 2014).

⁸ UN Human Rights Council, ‘The United Nations Guiding Principles on Business and Human Rights’ (2011) <http://www.ohchr.org/Documents/Publications/GuidingPrinciplesBusinessHR_EN.pdf> accessed 26 November 2018.

⁹ Stéphanie Bijlmakers, *Corporate Social Responsibility, Human Rights and the Law* (Routledge Research in Sustainability and Business, Routledge 2018), 72.

¹⁰ For further details, see International Law Association, ‘ILA Study Group on Due Diligence in International Law - First Report’ (2014) and International Law Association, ‘ILA Study Group on Due Diligence in International Law - Second Report’ (2016), 24 f.



as a voluntary standard whose adherence implies a legal advantage.¹¹ Finally, companies perform due diligence in the course of business transactions such as mergers and acquisitions.¹² The term due diligence thus has a multi-faceted history.

Human rights due diligence, on the other hand, is a novel concept. It is a management process that resembles, if at all, due diligence as applied in corporate practice. In contrast to its namesake, however, HRDD shifts the focus from the risks to the business enterprise itself to the risks for external human rights holders.¹³ The UNGPs design the concept as a series of four procedural steps.¹⁴ In order to conduct HRDD, a company must (1.) assess its actual and potential human rights impacts, (2.) integrate and act upon the findings, (3.) track responses, and (4.) communicate how the impacts are addressed.¹⁵ The scope of this process covers, on the one hand, cases where the company directly causes adverse human rights impacts and, on the other hand, situations where a third party is the perpetrator while the business either contributes to the impact or is linked to it through its business relationships.¹⁶

Despite the diversity of business models in times of globalisation, the UNGPs expect *all* business enterprises alike to engage in HRDD.¹⁷ Given this wide scope of application, the implementation of HRDD allows for some flexibility to adapt the process to the particular business context of the relevant company.¹⁸ The extent of the process, for instance, is contingent on the size of the business enterprise.¹⁹ Another consideration is the nature and context of the business operation. The most important factor, however, is the severity of the actual or potential human rights impact. Instead of a one-size-fits-all solution, the UNGPs thus propose a flexible management process that can be customised to the relevant context.

In addition, the UNGPs allow businesses under certain conditions to set priorities. According to the commentary to Principle 17 of the framework, companies that 'have large

¹¹ Olivier de Schutter and others, 'Human Rights Due Diligence: The Role of States' (2012), 16 f.

¹² For further information, see Linda S Spedding, *The due diligence handbook: Corporate governance, risk management and business planning* (1st ed. CIMA 2009), 6.

¹³ UN Human Rights Council, 'The United Nations Guiding Principles on Business and Human Rights' (2011) <http://www.ohchr.org/Documents/Publications/GuidingPrinciplesBusinessHR_EN.pdf> accessed 26 November 2018, commentary to Principle 17.

¹⁴ International Law Association, 'ILA Study Group on Due Diligence in International Law - Second Report' (n 10), 31.

¹⁵ UN Human Rights Council, 'The United Nations Guiding Principles on Business and Human Rights' (n 13), Principle 17.

¹⁶ See also *ibid* principle 13; International Law Association, 'ILA Study Group on Due Diligence in International Law - Second Report' (n 10) 30 f.

¹⁷ UN Human Rights Council, 'The United Nations Guiding Principles on Business and Human Rights' (n 13), General Principles.

¹⁸ Bijlmakers (n 9), 74.

¹⁹ UN Human Rights Council, 'The United Nations Guiding Principles on Business and Human Rights' (n 13), Principle 17 (b).



numbers of entities in their value chains [are allowed to] identify general areas where the risk of adverse human rights impacts is most significant [...] and prioritize these for human rights due diligence'.²⁰ This provision allows companies an efficient resource allocation by focusing on those sectors that imply the greatest risks of negative human rights impacts. It applies, for example, to large multinational enterprises (MNEs) with numerous tiers in their global value chains or institutional investors that hold shares in dozens of investees.²¹ Finally, the UNGPs define HRDD as a continuous exercise. Thus, a company must reassess actual and potential human rights impacts

prior to a new activity or relationship; prior to major decisions or changes in the operation (e.g. market entry, product launch, policy change, or wider changes to the business); in response to or anticipation of changes in the operating environment (e.g. rising social tensions); and periodically throughout the life of an activity or relationship.²²

In light of the challenges of a globalised world economy, HRDD constitutes a promising tool to address cases of business-related human rights abuses. The approach requires companies to assess and address human rights impacts throughout global value chains and investment networks. In this way, HRDD can shed light on nebulous chains of production through impact assessments that extend to suppliers and sub-suppliers. In addition, parent companies of corporate groups are expected to monitor the human rights impacts of their subsidiaries and business partners under control without compromising the well-established corporate law principles of limited liability and legal separation.²³ In light of these considerations, HRDD is an eligible approach to address the global governance gap described.

The major challenge, however, concerns the implementation of HRDD processes in practice. For one thing, the UNGPs only define general principles that still require further substantiation in practice. Furthermore, the framework constitutes soft law and lacks an own enforcement mechanism.²⁴ To date, the implementation of the UNGPs has mostly taken place through its contentual reproduction by other transnational corporate social responsibility (CSR) instruments.²⁵ One example are the updated Guidelines for

²⁰ *ibid*, commentary to Principle 17.

²¹ See for instance Steven B Young, Alberto Fonseca and Goretty Dias, 'Principles for responsible metals supply to electronics' (2010) 6(1) *Social Responsibility Journal* 126, 131 (stating that the production of electronic devices can spread over value chains with up to 50 tiers).

²² UN Human Rights Council, 'The United Nations Guiding Principles on Business and Human Rights' (n 13), commentary to Principle 18.

²³ Mark B Taylor, 'Human Rights Due Diligence: The Role of States - 2013 Progress Report' (2013), 13.

²⁴ Karin Buhmann, 'Business and human rights: Understanding the UN Guiding Principles from the perspective of transnational business governance interactions' (2015) 6(2) *Transnational Legal Theory* 399, 28 (stressing that the UNGPs have 'no enforcement mechanism of their own and [...] limited specific implementation modalities').

²⁵ *ibid*, 28.



Multinational Enterprises from 2011 developed by the Organisation for Economic Co-operation and Development (OECD Guidelines).²⁶ In line with the UNGPs, the document recommends companies 'risk-based due diligence' as a general instrument to address not only human rights impacts, but also matters of employment, environment, corruption, and consumer interests.²⁷ Comparable uptakes of the due diligence approach can be found in other international guidance documents.²⁸ Similar to the UNGPs, however, these reproductions constitute soft law that lack effective enforcement mechanisms.

Under these circumstances, it is ultimately upon business actors to voluntarily put HRDD into practice. In theory, companies are in the position to take the lead by implementing solid and effective processes under consideration of their capacities and context. The abstractness and non-binding nature of the UNGPs, however, entail the risk of insufficient implementation. At this point, regulation can come into play. In the context of the state duty to protect human rights, the UNGPs refer to domestic legislation with extraterritorial implications as one instrument to address business-related human rights abuses.²⁹ The UN framework specifies that states 'should consider a smart mix of measures – national and international, *mandatory* and voluntary – to foster business respect for human rights'.³⁰ As HRDD lies at the core of the responsibility to respect for human rights, a case can be made for legislation to enhance effective HRDD processes.³¹ Regulating HRDD would, for one thing, provide additional means of enforcement. In addition, it could clarify the concept, provide legal certainty, and reward best practices.³²

Recognising this role of unilateral regulation, legislators in Europe have taken up on this issue. Today, there is an increasing set of EU and European national norms that promote HRDD processes. On the EU level, there is the Directive 2014/95/EU that demands large corporations and corporate groups to report inter alia about their human rights policies

²⁶ OECD, 'Guidelines for Multinational Enterprises' (2011).

²⁷ *ibid* II. General Policies, A. paragraphs 10-13; see also Karin Buhmann, 'Teaching Note: Human Rights Due Diligence' in Teaching Business and Human Rights Forum (ed), *Teaching Business and Human Rights Handbook* (2018).

²⁸ See, for example, OECD, 'OECD Due Diligence Guidance for Responsible Supply Chains of Minerals from Conflict-Affected and High-Risk Areas: Third Edition' (2016); United Nations Global Compact and Office of the High Commissioner for Human Rights, 'The UN Guiding Principles on Business and Human Rights: Relationship to UN Global Compact Commitments' (June 2014) <https://www.unglobalcompact.org/docs/issues_doc/human_rights/Resources/GPs_GC%20note.pdf> accessed 12 February 2019.

²⁹ UN Human Rights Council, 'The United Nations Guiding Principles on Business and Human Rights' (n 13), commentary to Principle 2.

³⁰ *ibid*, commentary to Principle 3 (emphasis added).

³¹ Andreas Rasche, Mette Morsing and Jeremy Moon (eds), *Corporate social responsibility: Strategy, communication, governance* (Cambridge University Press 2017), 392.

³² On the necessity to clarify the UNGPs, see Bijlmakers (n 9), 83.



including the due diligence processes implemented.³³ In 2017, the EU adopted furthermore Regulation (EU) 2017/821 which lays down supply chain due diligence obligations for Union importers of specific minerals and metals from conflict-affected and high-risk areas.³⁴ Among other objectives, the act intends to protect human rights at the outset of mineral sourcing chains by means of due diligence processes.³⁵

On the national level, there is furthermore the French Duty of Vigilance Law from 2017.³⁶ In a nutshell, this act demands large French companies to submit a so-called *vigilance plan* to

identify and prevent adverse human rights and environmental impacts resulting from their own activities, from activities of companies they control, and from activities of their subcontractors and suppliers, with whom they have an established commercial relationship.³⁷

Besides, further developments are pending. In Switzerland, a popular initiative strives for the inclusion of mandatory HRDD provisions in the Swiss constitution.³⁸ The draft proposal obliges companies based in Switzerland 'to carry out appropriate due diligence' with respect to human rights and environmental impacts throughout their commercial activities including foreign subsidiaries or business partners under control.³⁹ If a Swiss company cannot prove appropriate due diligence measures, it would face civil liability.⁴⁰ Similar developments are taking place in Germany. The German government decided in 2016 that '[i]f fewer than 50 % of the enterprises [...] have incorporated the elements of human rights due diligence [...] by 2020 [...], the Federal Government will consider further action, which may culminate in legislative measures'.⁴¹ In February 2019, it became known that the German Federal Ministry for Development and Economic Cooperation is currently drafting

³³ See Article 19a (1) (b) Directive 2014/95/EU of the European Parliament and of the Council 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.

³⁴ 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, OJ L 130/1 [2017].

³⁵ *ibid.*, recital 3.

³⁶ Loi n° 2017-399 du 27 mars 2017 relative au devoir de vigilance des sociétés mères et des entreprises donneuses d'ordre 27 March 2017 (République Française).

³⁷ European Coalition for Corporate Justice, 'French Corporate Duty Of Vigilance Law - Frequently Asked Questions' (24 March 2017) <<http://corporatejustice.org/documents/publications/french-corporate-duty-of-vigilance-law-faq.pdf>> accessed 6 March 2019, 2.

³⁸ Swiss Coalition for Corporate Justice (Konzernverantwortungsinitiative), 'The initiative text with explanations' (2016) <<https://corporatejustice.ch/about-the-initiative/>> accessed 5 May 2017

³⁹ *ibid.*

⁴⁰ *ibid.*

⁴¹ Federal Republic of Germany, 'National Action Plan: Implementation of the UN Guiding Principles on Business and Human Rights 2016 – 2020' <<https://www.auswaertiges-amt.de/blob/610714/fb740510e8c2fa83dc507afad0b2d7ad/nap-wirtschaft-menschenrechte-engl-data.pdf>> accessed 31 January 2019, 10.



such legislative measures.⁴² According to this first reports, the act would require large German corporations to conduct mandatory HRDD throughout their global supply chains.

All these developments illustrate a clear trend: promoting HRDD processes by means of business law. The concept is hence taken up from international soft law and transferred into different areas of (hard) business regulation.⁴³ My PhD project aims to keep track of this development. It explores the prospects and limitations of the HRDD approach in view of relevant legislation in Europe, namely, Directive 2014/95/EU, Regulation (EU) 2017/821 and the French Duty of Vigilance Law. This conference paper provides an extract of the current state of my research. It discusses and approves, first of all, the theory of meta-regulation as an appropriate framework to evaluate the effectiveness of HRDD legislation (section II.). In a second step, these theoretical considerations are tested on the example of Directive 2014/95/EU (Section III.). Drawing upon both, the theoretical considerations and the case example, Section III concludes.

II. Drafting a theoretical framework

In order to assess the effectiveness of HRDD legislation and, subsequently, to develop proposals for legal reform, it is necessary to define adequate benchmarks. However, legislation on HRDD processes is still at an early stage which is why there is a lack of empirical data. For that reason, the necessary benchmarks must be grounded in theory. Against this background, the following section discusses the theory of meta-regulation and its suitability for the assessment of HRDD legislation.

The theory of meta-regulation presumes that governance occurs on different levels and through different actors.⁴⁴ It draws consequently upon a division of regulatory functions between the state, on the one hand, and non-state actors including corporations, on the other. Traditional command-and-control regulation on the part of the state is therefore only one node in a multidimensional global governance network that features also international organisations, MNEs, civil society organisations, and business associations. On that basis, meta-regulation assumes that a policy objective is best pursued by combining different modes of governance. In the area of business regulation, this implies an interplay between the regulatory clout of the law and the internal capacities of companies to regulate their

⁴² Business and Human Rights Resource Centre, 'Will Germany become a leader in the drive for corporate due diligence on human rights?' (20 February 2019) <<https://www.business-humanrights.org/en/will-germany-become-a-leader-in-the-drive-for-corporate-due-diligence-on-human-rights>> accessed 6 March 2019.

⁴³ Bijlmakers (n 9), 77 f.

⁴⁴ Christine Parker, 'Meta-Regulation: Legal Accountability for Corporate Social Responsibility' in Doreen J McBarnet (ed), *The new corporate accountability: Corporate social responsibility and the law* (1. paperback ed. Cambridge Univ. Press 2007), available at <https://ssrn.com/abstract=942157>, 5 f.



own affairs. Against this background, meta-regulation theory provides the prerequisites of effective corporate self-regulation and defines criteria for accompanying law-making.

In my view, this approach applies aptly to the case of HRDD legislation. On the one hand, the recourse to self-regulation matches with the role of businesses in conducting HRDD. By definition, self-regulation describes the design of internal management processes with the aim to ensure compliance with a specific objective.⁴⁵ As pointed out in the introduction, the application of HRDD requires companies to design internal human rights processes to assess actual and potential human rights impacts, integrate and act upon the findings, track responses, and disclose the processes and outcomes.⁴⁶ These four steps form an internal management process with the specific objective to respect human rights. Insofar, HRDD is nothing but a special case of self-regulation.

Furthermore, meta-regulation defines the role of law in relation to the capacities of companies to govern their own activities. This role lies in the facilitation of effective corporate self-regulation from the *meta* level. The theory aims thereby to strike a balance between corporate leeway and state intervention and defines benchmarks to assess the prospects of business regulation. Meta-regulation applies thereby aptly to the negative implications of business activity. In the words of the regulatory theorist, Christine Parker, the ‘conception of legal meta-regulation is a useful tool for evaluating proposals to use law to encourage or enforce CSR [corporate social responsibility]’.⁴⁷ Given this match between the meta-regulation theory and the regulation promoting HRDD as a special case of self-regulation, the approach constitutes a suitable theoretical framework for a regulatory assessment.

Before delving into the characteristics of meta-regulation, however, it is necessary to briefly consider the role companies. For this matter, Christine Parker has coined the notion of the ‘open corporation’ which describes a business entity that applies effective self-regulation processes.⁴⁸ In order to become open corporations, businesses must go through three successive stages of development referred to as ‘the institutionalisation of social and legal responsibility’.⁴⁹ At the first stage, the purpose of a self-regulatory process must enjoy the full commitment of the senior management. This aspect recognises the hierarchical structures of corporations. Only if a matter of compliance is on the agenda of the high-level

⁴⁵ Christine Parker, *The open corporation: Effective self-regulation and democracy* (Cambridge University Press 2002).

⁴⁶ UN Human Rights Council, ‘The United Nations Guiding Principles on Business and Human Rights’ (n 13), Principle 17.

⁴⁷ Parker, ‘Meta-Regulation: Legal Accountability for Corporate Social Responsibility’ (n 44), 5.

⁴⁸ Christine Parker, ‘Meta-regulation: The regulation of self-regulation’ in Christine Parker (ed), *The Open Corporation* (Cambridge University Press 2002).

⁴⁹ Parker, *The open corporation* (n 45), 60.



management, it stands a chance of being addressed successfully. Effective self-regulation necessitates secondly competent staff 'to bridge the gap between the values of the wider society [...] and the pursuit of business'.⁵⁰ The responsible department must be capable and competent to translate external legal requirements and expectations of responsible business conduct into everyday business operations.⁵¹ Fulfilling this task demands intermediation – conciliating between the company and external actors such as legislators, civil society organisations or investors.⁵² In addition, there is a political role to play which requires 'the clout to force issues onto the agenda at the highest level, the savvy to raise them at middle management level, and the support to educate for and enforce them at lower levels'.⁵³

The third and final stage is concerned with the integration of responsibilities into operating procedures and performance appraisals.⁵⁴ For that purpose, companies must utilise the ethical human capital of its employees. Thus, a self-regulation system must integrate the personal values of the employees, for example, by enabling them to design their own workplace procedures or by establishing complaint hotlines and whistle-blower policies.⁵⁵ In addition, the company must take an 'opening-out' approach. This requires the disclosure of information on the design and performance of the self-regulation system and continuous dialogue with relevant stakeholders.⁵⁶ Integrating responsibility requires furthermore compliance departments with a clear mandate and sufficient clout, independent access to the highest representatives of the company, and protection against unfair dismissal. These measures increase the awareness of the management for compliance and CSR issues, trigger information flows which allow the board to exercise sufficient oversight and facilitate internal conflict resolution. Finally, effective self-regulation demands a process of self-evaluation. Only if companies examine their self-regulation efforts in relation to their objectives, they can redesign and reform deficient policies in the long run. Through 'double-loop learning' flexible systems can emerge which enhance compliance and corporate social responsibility.⁵⁷

After all, the institutionalisation of social and legal responsibility is incumbent upon the individual company. However, each of the three phases described allows for external stimuli. Such external influence is exerted by regulators and other stakeholders such as civil society organisations, the media, investors, and consumers. All these actors can

⁵⁰ Parker, *The open corporation* (n 45), 112.

⁵¹ *ibid* 115.

⁵² *ibid* 176.

⁵³ *ibid* 182.

⁵⁴ *ibid* 197 f.

⁵⁵ *ibid* 203 f.

⁵⁶ *ibid* 222.

⁵⁷ *ibid* 233-240.



consequently steer the implementation of effective self-regulation processes. The capacity of external stimuli to trigger effective processes depends thereby on the stage of development of the individual company. Against this background, the role of corporate law is twofold: firstly, to drive change in business conduct by exerting its own influence and, secondly, by enabling other stakeholders to do their bit. To guide law-makers in this role, Christine Parker defines three benchmarks which indicate the effectiveness of business law in facilitating the institutionalisation of social and legal responsibility by companies.⁵⁸ First of all, regulation must define a substantial policy objective that goes beyond the 'narrow self-interest' of profitability.⁵⁹ In this way, lawmakers can guide corporate compliance measures and align it with the telos of the law. Secondly, companies must be required 'to put in place formal governance structures and management systems that help produce a responsible culture and management in practice'.⁶⁰ Possible means of implementation include hereby high-level compliance commitments which are then institutionalised internally (for example, in performance measurement systems). Other measures are internal and external complaint mechanisms and grievances as well as continuous revaluations of the compliance system, for example, on the basis of external audits. Finally, a meta-regulatory approach to governance must 'allow space for the company to take responsibility itself'.⁶¹ Thus, compliance with the law should not compromise the ability of a company to perform successfully on the market. Instead, the law must clearly define a framework within which businesses can 'decide for themselves how to institutionalise responsibility'.⁶² To assess the performance of measures within the set framework, alternative forms of governance such as communication laws or audit requirements are best suited. In that way, the law enables stakeholders to play the role of a corporate watchdog.

Based on the foregoing considerations, several conclusions can be drawn for the specific case of HRDD legislation. For one thing, regulation incorporating HRDD must clearly define its objective which is the prevention of negative human rights impacts in the context of commercial activity. It must thus clarify that HRDD is not a box-ticking exercise, but a goal-oriented and continuous management process. Second of all, companies have to be required to design internal structures and management processes that consider the matter of adverse human rights impacts. Accounts of HRDD in international frameworks such as the UNGPs provide suitable blueprints. As pointed out already, the UNGPs conceptualises HRDD in four consecutive steps: a comprehensive impact assessment process, a

⁵⁸ Parker, 'Meta-Regulation: Legal Accountability for Corporate Social Responsibility' (n 44), 14 f.

⁵⁹ *ibid*, 14.

⁶⁰ *ibid*, 15.

⁶¹ *ibid*, 16.

⁶² *ibid*, 16.



subsequent management of actual or potential impacts, a monitoring of the outcomes, and, finally, the disclosure of the policies in place. All four steps are thereby mutually reinforcing. Furthermore, a HRDD process necessitates active engagement with relevant stakeholders and must be evaluated in regular intervals to enhance its effectiveness over time. Relevant legislation must therefore ensure comprehensive and continuous HRDD processes that take external concerns into account.

Finally, a meta-regulatory approach to HRDD legislation must grant companies the leeway to tailor their compliance strategy to the relevant business context. Thus, companies need a margin of appreciation within set boundaries. This element of flexibility is already inherent in the HRDD process itself. As pointed out before, the extent of a due diligence process varies, primarily, with the severity and probability of an impact and, subordinately, with the capacity of a company, the specific business sector, and the priorities set by the business actor. Regulation promoting HRDD must recognise these elements of flexibility. Otherwise, it risks overburdening companies in terms of resources and expertise.

Taken together, these three benchmarks provide a preliminary theoretical framework to assess the effectiveness of legislation on HRDD processes. On the basis of the criteria defined, the subsequent section turns to the application of said framework under consideration of Directive 2014/95/EU.

III. The case example of Directive 2014/95/EU

EU Directive 2014/95/EU regards the disclosure of non-financial and diversity information by certain large undertakings and groups.⁶³ What makes the act interesting from a business and human rights perspective is one of its regulatory objectives.⁶⁴ The Directive demands the disclosure of non-financial information not only to serve the interests of investors to assess the financial value of a company (i.e. the traditional purpose of *financial* disclosure), but also aims to steer corporate behaviour towards more sustainability.⁶⁵ One aspect of this sustainability agenda is business *respect for human rights*. In order to pursue this objective, the Directive draws explicitly on due diligence processes. Directive 2014/95/EU is therefore a suitable case example of a law that promotes HRDD processes. The

⁶³ Directive 2014/95/EU of the European Parliament and of the Council amending Directive 2013/34/EU as regards disclosure of non-financial and diversity information by certain large undertakings and groups (n 33).

⁶⁴ Besides, the Directive also introduces transparency rules on the diversity policy in administrative, management and supervisory bodies of large companies. Given the focus on respect for human rights and due diligence, however, the following inquiry leaves the diversity aspects out of consideration.

⁶⁵ See Directive 2014/95/EU of the European Parliament and of the Council amending Directive 2013/34/EU as regards disclosure of non-financial and diversity information by certain large undertakings and groups (n 33), recital 3 (holding that ‘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’).



remainder of this section (1.) first introduces the context, scope and, key provisions of the Directive.⁶⁶ In a second step (2.), the act's account of respect for human rights and due diligence is evaluated. The final part (3.), in turn, assesses the act against the benchmarks of effective meta-regulation defined in the previous section.

1. Context, scope and key provisions of Directive 2014/95/EU

The idea to promote respect for human rights through accounting provisions is nothing but new. Already the UNGPs recommend regulators to '[e]ncourage, and where appropriate *require*, business enterprises to communicate how they address their human rights impacts'.⁶⁷ The EU adopted the Directive in October 2014 with a deadline for transposition of 6 December 2016. Given the retrospective viewpoint of annual reporting, the rules were first applied in 2018 with respect to the previous fiscal year.⁶⁸

In terms of scope, Directive 2014/95/EU applies to all public-interest entities with an average number of more than 500 employees and either a balance sheet total exceeding 20 million Euro or a net turnover exceeding 40 million Euro per financial year.⁶⁹ According to the European Commission, about 6000 large companies and groups are falling in this scope of application.⁷⁰ These regulatory addressees are required to include a non-financial statement in their annual management reports.⁷¹ In case of consolidated accounting, it is on the parent undertaking of a large group⁷² with more than 500 employees on average to

⁶⁶ For reasons of clarity, the following sections focus primarily on the provisions on individual non-financial reporting (Article 19a). These norms are generally congruent with the those on consolidated disclosure (Article 29a). Where relevant deviations remain, however, the norms on consolidated reporting are considered in more detail.

⁶⁷ UN Human Rights Council, 'The United Nations Guiding Principles on Business and Human Rights' (n 13) Principle 3 (d) (emphasis added).

⁶⁸ European Commission, 'Guidelines on non-financial reporting: (methodology for reporting non-financial information)' (2017/C 215/01, 5 July 2017), 1.

⁶⁹ Article 19a (1) Directive 2014/95/EU of the European Parliament and of the Council amending Directive 2013/34/EU as regards disclosure of non-financial and diversity information by certain large undertakings and groups (n 33); Public-interest entities are companies whose transferable securities are admitted to trading on a Member State market, as well as specific credit institutions, insurance undertakings, and other legal entities as designated by the Member States, see Article 2 (1) 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 [2013], OJ L 182/19.

⁷⁰ Website of the European Commission, 'Non-financial reporting: EU rules require large companies to publish regular reports on the social and environmental impacts of their activities.' <https://ec.europa.eu/info/business-economy-euro/company-reporting-and-auditing/company-reporting/non-financial-reporting_en> accessed 8 February 2019.

⁷¹ Alternatively, the Member States can allow reporting undertakings and groups to provide the required information in a separate report, see Article 19a (4) Directive 2014/95/EU of the European Parliament and of the Council amending Directive 2013/34/EU as regards disclosure of non-financial and diversity information by certain large undertakings and groups (n 33). However, such disclosure requires that the separate report is either released together with the management report or available on the business's homepage as referred to in the management report.

⁷² As defined in Article 3 (7) 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



include a consolidated non-financial statement covering the entire group in its consolidated management report.⁷³ If an enterprise falling under the scope of the Directive is already included in the consolidated non-financial statement of a large group, on the other hand, it is exempted from the individual reporting requirement.⁷⁴

As regards content, the non-financial statement must include

information to the extent necessary for an understanding of the undertaking's development, performance, position and impact of its activity, relating to, as a minimum, environmental, social and employee matters, *respect for human rights*, anti-corruption and bribery matters.⁷⁵

With regard to each of these non-financial topics, the Directive demands consideration of five different aspects. In total, the non-financial statement must contain

- (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.⁷⁶

Importantly, the Directive does not determine what policies and reporting methodologies should be applied. Instead, it refers companies to recognised national, European or international CSR standards.⁷⁷ Recital 9 of the Directive provides a non-exhaustive list of examples. In view of these options, a company can select and apply its framework of choice.⁷⁸ Alternatively, the Directive also permits businesses to develop and apply their

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 (n 68).

⁷³ Article 29a (1) Directive 2014/95/EU of the European Parliament and of the Council amending Directive 2013/34/EU as regards disclosure of non-financial and diversity information by certain large undertakings and groups (n 33).

⁷⁴ Article 19a (3) *ibid.*

⁷⁵ Article 19a (1) *ibid.* (emphasis added).

⁷⁶ Article 19a (1) *ibid.*

⁷⁷ Article 19a (1) subpar. (5) and Article 29a (1) subparagraph (5) *ibid.*; on the underlying policy approach, Deirdre Ahern, 'Turning Up the Heat? EU Sustainability Goals and the Role of Reporting under the Non-Financial Reporting Directive' (2016) 13(4) *European Company and Financial Law Review* 599, 616.

⁷⁸ Ahern (n 76), 616.



own approach.⁷⁹ With respect to auditing, the Directive stipulates that the competent statutory auditor or audit firm must verify that a company provides a non-financial statement.⁸⁰ Its content, on the other hand, must only be reviewed if the transposing Member State demands it.⁸¹

From a regulatory perspective, the Directive combines mandatory reporting rules and so-called *comply or explain provisions*. The five aspects of a non-financial statement enshrined in Article 19 (1) (a-e) are thereby subjects to different regulatory approaches. The requirements to include (a) a brief description of the business model and (d) a risk characterisation under consideration of (e) relevant non-financial key performance indicators are strictly mandatory.⁸² In other words, every non-financial statement must contain these pieces of information.

The provisions to disclose (b) the applied CSR policies (including due diligence processes), (c) the outcomes of those policies, and (d) a description of the means of risk management, by contrast, are subject to a comply or explain rule.⁸³ This regulatory approach grants the reporting entity the freedom either to *comply* with a standard or to *explain* its reasons not to do so.⁸⁴ Accordingly, companies are not obliged to *conduct* CSR policies including due diligence processes, track their outcomes, and conduct CSR risk management. But, if a reporting business ‘does not pursue policies in relation to one or more [CSR matter], the non-financial statement shall provide a clear and reasoned explanation for not doing so’.⁸⁵ In this way, a company is free not to address environmental, social and employee matters, anti-corruption and bribery issues or respect for human rights. The justification requirement, however, exposes this decision and sheds light on the underlying reasoning.

A follow-up question is whether the comply or explain provision also extends to the decision whether to apply due diligence. In other words, is a company required to give a clear and reasoned explanation why it does not pursue due diligence processes – inter alia regarding

⁷⁹ European Commission, ‘Guidelines on non-financial reporting’ (n 67), 3; also Ahern (n 53), 617 and 619.

⁸⁰ Article 19a (5) and Article 29a (5) Directive 2014/95/EU of the European Parliament and of the Council amending Directive 2013/34/EU as regards disclosure of non-financial and diversity information by certain large undertakings and groups (n 33).

⁸¹ Article 19a (6) and Article 29a (6) *ibid*.

⁸² European Commission, ‘Guidelines on non-financial reporting’ (n 67), 11.

⁸³ See Article 19a (1) subparagraph 2 Directive 2014/95/EU of the European Parliament and of the Council amending Directive 2013/34/EU as regards disclosure of non-financial and diversity information by certain large undertakings and groups (n 33); as far as a company pursues CSR policies, it must also report about relevant non-financial KPIs (e).

⁸⁴ Leyens (n 83), 157 f.; Quinn and Connolly (n 176), 17; Patrick Kroker, ‘Menschenrechte in der Compliance’ [2015] Corporate Compliance Zeitschrift 120, 124.

⁸⁵ Article 19a (1) Directive 2014/95/EU of the European Parliament and of the Council amending Directive 2013/34/EU as regards disclosure of non-financial and diversity information by certain large undertakings and groups (n 33).



human rights? The relevant literature answers this question negatively arguing that ‘the mere lack of a due diligence process does not even need to be explained because a duty to explain is only assumed where a concept is missing in its entirety and not where due diligence processes as part of a concept are lacking’.⁸⁶ The subordinate decision not to engage in due diligence is consequently not covered by the comply or explain rule. Consequently, companies do not need to justify their decision not to apply due diligence processes regarding human rights.

2. Respect for human rights and due diligence

Having explained the basic provisions of Directive 2014/95/EU, this section examines the act as a regulatory tool to address business-related human rights abuses. What does respect for human rights and due diligence in the terminology of the Directive actually imply? This question is assessed on the basis of the relevant provisions and recitals.

a) Respect for human rights

First, it is necessary to take a closer look at the term *respect for human rights* in Article 19a (1). While the notion is unprecedented in EU law, it matches the terminology of the UNGPs. The identical wording, however, does not condense in substance. The UN framework comprehends *respect for human rights* as (i) the adoption of a human rights policy commitment, (ii) the implementation of human rights due diligence processes, and (iii) the set-up of measures to safeguard remediation in case of adverse human rights impacts.⁸⁷ Directive 2014/95/EU, in contrast, does not define what qualifies as respect for human rights. Instead, it applies the term to describe a category of CSR reporting. This category, in turn, is divided into five different pieces of information (thus, a brief description of the business model, a description of the pursued CSR policies and their outcome, the principal risks and their management, and relevant non-financial key performance indicators). The only overlap with the UNGPs is the brief reference to due diligence processes in Article 19a (1) (b) which will be further assessed in the subsequent section. All the other characteristics of the corporate responsibility to respect human rights as

⁸⁶ Alexander Scheuch, ‘Soft Law Requirements with Hard Law Effects? The Influence of CSR on Corporate Law from a German Perspective’ in Jean J Du Plessis, Umakanth Varottil and Jeroen Veldman (eds), *Globalisation of Corporate Social Responsibility and its Impact on Corporate Governance* (Springer International Publishing 2018), 207 referring to Deutscher Bundestag (German Parliament), ‘Entwurf eines Gesetzes zur Stärkung der nichtfinanziellen Berichterstattung der Unternehmen in ihren Lage- und Konzernlageberichten (Government Draft for the Transposing Act of the CSR Directive)’ (17 October 2016). Bundestag Drucksache 18/9982, 52; also Matthias Schmidt, ‘Wie weit reichen die Berichtspflichten der CSR-Richtlinie?: Lageberichterstattung über Nachhaltigkeitsaspekte vor dem Hintergrund der CSR-Richtlinie’ [2016] *Anwaltsblatt* 390 and Klaus J Hopt and others, *Handelsgesetzbuch: Mit GmbH & Co. Handelsklauseln, Bank- und Börsenrecht, Transportrecht (ohne Seerecht)* (Beck’sche Kurz-Kommentare Band 9, 38. neubearbeitete Auflage 2018, C.H. Beck 2018), § 289c paragraph 16.

⁸⁷ See principal 15, UN Human Rights Council, ‘The United Nations Guiding Principles on Business and Human Rights’ (n 13).



defined in the UNGPs are not mentioned. By defining respect for human rights as a category of reporting without supplementary specifications, the Directive leaves it to the reporting entity to implement respect for human rights in practice. A company can therefore not only choose not to engage in respect for human rights at all, it can also decide to do so on its own terms. As a result, *respect for human rights* in the meaning of the Directive remains an open-ended concept whose materialisation lies in the hands of the reporting entity.

b) The role of due diligence processes

As pointed out before, the Directive does not require businesses to engage in CSR policies or due diligence processes. However, if a company adopts policies regarding one or more CSR matter, it is obliged to report about it. Articles 19a (1) (b) determines that the non-financial statement must include ‘a description of the policies pursued by the undertaking in relation to those matters, including *due diligence processes implemented*’ (emphasis added). Recital 6 specifies the meaning of due diligence in the context of the Directive. The recital describes the term as the steps taken ‘to identify, prevent and mitigate existing and potential adverse impacts’. Accordingly, the Directive comprehends due diligence as a general (as opposed to a human rights specific) management tool that includes two stages: first of all, the identification of principal CSR risks and materialised CSR impacts and, secondly, the response to these findings. On the stage of response, a company must either take preventive measures regarding principal risks or mitigative action to address actual adverse impacts. ‘[W]here relevant and proportionate’, the scope of a due diligence process extends hereby to the ‘supply and subcontracting chains’.⁸⁸

In comparison with the UNGPs, the Directive’s account of due diligence processes is rather disorganised. As pointed out before, the UN framework describes HRDD in four steps: ‘[1.] assessing actual and potential human rights impacts, [2.] integrating and acting upon the findings, [3.] tracking responses, and [4.] communicating how impacts are addressed’.⁸⁹ The general definition of due diligence in recital 6, in contrast, only contains two steps. Furthermore, the Directive only refers to due diligence in the context of CSR policies (Article 19a (1) (b)) and not with respect to policy outcomes or the identification and management of risks (Article 19a (1) (c) and (d)). Despite this conceptual mismatch, all four stages of a due diligence process in the meaning of the UNGPs are somehow reflected in Directive 2014/95/EU. The following section attempts to clarify the matter.

⁸⁸ Recital 6 Directive 2014/95/EU of the European Parliament and of the Council amending Directive 2013/34/EU as regards disclosure of non-financial and diversity information by certain large undertakings and groups (n 33).

⁸⁹ UN Human Rights Council, ‘The United Nations Guiding Principles on Business and Human Rights’ (n 13) Principle 17.



Utilising the four-step approach of the UNGPs, it determines to what extent Directive 2014/95/EU regulates the different components of a HRDD process.

i) Human rights impact assessment

The initial step of a HRDD process concerns the comprehensive assessment of adverse human rights impacts. According to the UNGPs, its 'purpose is to understand the specific impacts on specific people, given a specific context of operations'.⁹⁰ The assessment should thereby also cover the impacts entailed in the business relationships.⁹¹ At first sight, Directive 2014/95/EU does not require the assessment of human rights impacts. Instead, it demands the *disclosure* of information. Article 19a (1) (d) states that the non-financial statement must take account of 'the *principal risks* related to those [i.e. CSR] 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'. As pointed out before, this requirement is not subject to the comply or explain rule, but mandatory. A reporting entity is therefore obliged to disclose the *principal risks* of its commercial activity – also regarding human rights.⁹² Requiring companies to report about their CSR risks eventually implies a duty to gather the necessary information. The process of information gathering, on the other hand, is essential to a risk assessment. In this way, Directive 2014/95/EU *de facto* imposes a duty to assess general human rights risks.

In contrast to the UNGPs, however, the Directive speaks of *principal risks* and not of *impacts*. This raises the question of what qualifies as a risk. Recital 8 specifies that companies 'should provide adequate information in relation to matters that stand out as being most likely to bring about the materialisation of *principal risks* of severe impacts, along with those that have already *materialised*' (emphasis added). Hence, the recital links the risk terminology back to the notion of impacts. The severity of those impacts is assessed on the basis of their scale and gravity. Recital 8 reveals furthermore a distinction between principal risks and materialised risks (which are synonymous with impacts). Based on this differentiation, every non-financial statement must provide a risk characterisation describing principal risks as well as actual impacts. With respect to human rights, it follows that companies must disclose both – potential risks of adverse human rights abuses (for example, the abstract risk of child labour in a specific region or sector) as well as actual cases of adverse human rights impacts (such as documented cases of child labour in a specific factory).

⁹⁰ *ibid*, commentary to Principle 18.

⁹¹ *ibid*, Principle 17 (1).

⁹² See also European Commission, 'Guidelines on non-financial reporting' (n 67), 13.



The disclosure of principal risks and negative impacts is particularly interesting under consideration of the applicable scope. According to Article 19a (1) (d), the risk characterisation also covers the *business relationships* of the reporting entity. These business relationships include all entities in the global supply and subcontracting chains.⁹³ Accordingly, the non-financial statement must principally disclose all severe human rights impacts as well as all likely and severe human rights risks entailed in a company's global business relations.

However, the Directive considers risks and impacts in global supply and subcontracting chains only necessary where this is 'relevant and proportionate'.⁹⁴ What qualifies as *relevant and proportionate*, on the other hand, is not specified. Lacking further clarification, it is ultimately upon the reporting company to decide whether those risks are worth reporting. The decision about the consideration of CSR risks in the global supply and subcontracting chains, on the other hand, is not covered by the comply or explain provision in Article 19a (1) subparagraph 2. A company is therefore not required to provide any reasons why it considers the risks in its business relationships as irrelevant or disproportionate. External stakeholders can therefore not scrutinise the respective decision. Granting reporting entities such leeway without a corresponding justification requirement renders the risk characterisation void of its normative strength. In my view, the ambiguous limitation to relevant and proportionate circumstances hinders the identification and disclosure of adverse human rights impacts in the business relationships in practice.⁹⁵

ii) Integrating and acting upon the findings

The second step of a HRDD process is to integrate and respond to the human rights risks and actual impacts identified. This stage is not explicitly addressed by the Directive. However, its substance is reflected in different disclosure requirements. On the one hand, Article 19a (1) (b) demands 'a description of the policies pursued [...] in relation to' matters of CSR including negative human rights impacts. If a company adopts a human rights policy, its major purpose would likely be to define how to integrate and respond to identified risks or negative impacts. Secondly, Article 19a (1) (d) requires a report on how the company manages inter alia its human rights risks. Managing human rights risks can hereby be understood as synonymous with responding to the findings of the risk

⁹³ See recitals 6 and 9 Directive 2014/95/EU of the European Parliament and of the Council amending Directive 2013/34/EU as regards disclosure of non-financial and diversity information by certain large undertakings and groups (n 33).

⁹⁴ Article 19a (1) (d) *ibid.*

⁹⁵ Andreas Rühmkorf, 'From Transparency to Due Diligence Laws? Variations in Stringency of CSR Regulation in Global Supply Chains in the 'Home State' Of Multinational Enterprises' in Jean J Du Plessis, Umakanth Varottil and Jeroen Veldman (eds), *Globalisation of Corporate Social Responsibility and its Impact on Corporate Governance* (Springer International Publishing 2018), 191 f.



assessment. Insofar, Directive 2014/95/EU touches upon the second step of a HRDD process. In terms of substance, however, the two provisions are rather ambiguous because they regulate aspects of disclosure and not how companies should design their policies and risk management.

Besides, both provisions (Article 19a (1) (b) and (d)) are subject to the comply or explain clause in Article 19a (1) subparagraph 2. Accordingly, companies are free not to engage in human rights policies or risk management and, consequently, not to report about it. In that case, however, reporting entities are obliged to justify their decision. Consequently, the comply or explain provision exposes the decision against appropriate action to the courts of public opinion. Not acting in light of identified risks and impacts might jeopardise a company's reputation. Insofar, the Directive creates at least an incentive to generally pursue a human rights policy and to manage human rights risks and impacts. However, it is not ensured that such measures match the requirements of a HRDD process.

iii) Tracking responses

In a third step, a company must 'track the effectiveness' of the preventive and mitigative actions applied.⁹⁶ This step 'is necessary in order for a business enterprise to know if its human rights policies are being implemented optimally, whether it has responded effectively to the identified human rights impacts, and to drive continuous improvement'.⁹⁷ Once again, Directive 2014/95/EU does not oblige companies to track and monitor the performance of their responses. Also, the definition of due diligence in recital 6 does not take this step into account. Yet, Article 19a (1) (c) stipulates that companies must report about the outcome of their human rights policies. The requirement to disclose the outcomes of the applied measures, in turn, necessitates a monitoring and tracking process to access the required information. Also reporting about policy outcomes is subject to the comply or explain rule in Article 19a (1) subparagraph 2. The justification requirement creates consequently not only an incentive to engage in human rights policies and risk management, but also to monitor the performance of these measures.

iv) Communication

Finally, due diligence implies communication. In this way, companies can 'know and show that they respect human rights in practice'.⁹⁸ The definition of due diligence in recital 6 does not consider this fourth step. Yet, the element of communication is obviously entailed in the different reporting requirements themselves. As pointed out before, the Directive obliges

⁹⁶ UN Human Rights Council, 'The United Nations Guiding Principles on Business and Human Rights' (n 13), Principle 20.

⁹⁷ *ibid*, commentary to Principle 20.

⁹⁸ *ibid*, commentary to Principle 21.



reporting entities to disclose a human rights risk characterisation. Thus, companies must give stakeholders insights into their human rights risks and impacts. An account of the risks and impacts in the global supply and subcontracting chains – which often pose the real challenge –, however, is only deemed necessary ‘where relevant and proportionate’. In principle, a non-financial statement must also elaborate on the applied CSR policies including due diligence processes, the outcome of those policies, and the human rights risk management. As pointed out before, these disclosures are subject to the comply or explain rule in Article 19a (1) subparagraph 2. Only if a company opts to take these steps it is also legally compelled to report about it. In sum, the Directive only legally requires the disclosure of CSR risks and impacts while it utilises the comply or explain rule to incentivise companies to take further action and, consequently, report about it.

v) Summary

Overall, Directive 2014/95/EU addresses the four stages of a due diligence process with a varying regulatory density. Although its scope is ill-defined, the first step – thus, the assessment of human rights impacts – is *de facto* mandatory. In contrast, the second and the third step of a due diligence process are only reflected in the differentiation between reporting about policies and risk management, on the one hand, and the outcome of those measures, on the other. With respect to the fourth and final feature of a due diligence process – communicating the efforts taken –, one needs to distinguish. While principle risks and impacts have to be disclosed, human rights policies, their outcomes, and risk management processes must only be revealed if a company actually performs such measures. Thus, the second, third and fourth stage of due diligence are subject to the comply or explain clause and therefore *voluntary with some reservations*.

c) The role of CSR standards

The doctrinal analysis as well as the assessment of the Directive’s account of due diligence reveal a considerable discretion on the part of reporting companies to materialise respect for human rights and the different steps of a due diligence process. The follow-up question that arises is how reporting entities are exercising this leeway in practice. Empirical evidence suggests that most companies rely on CSR standards.⁹⁹ One can therefore reasonably assume that companies also turn to CSR guidance documents to comply with Directive 2014/95/EU. As pointed out before, recital 9 of Directive 2014/95/EU refers reporting entities to a non-exhaustive list of seven European and international CSR

⁹⁹ KPMG International, ‘The KPMG Survey of Corporate Responsibility Reporting 2017’ (October 2017) <<https://assets.kpmg.com/content/dam/kpmg/xx/pdf/2017/10/kpmg-survey-of-corporate-responsibility-reporting-2017.pdf>> accessed 29 October 2018, 28 (stating that ‘[t]he majority of N100 (74 percent) and G250 companies (89 percent) are using some kind of guidance or framework for their reporting’).



standards. The list includes the Eco-Management and Audit Scheme (EMAS)¹⁰⁰ as an exemplary European framework and the United Nations Global Compact,¹⁰¹ the UNGPs,¹⁰² the OECD Guidelines,¹⁰³ the International Organisation for Standardisation's ISO 26000,¹⁰⁴ the International Labour Organisation's Tripartite Declaration of principles concerning multinational enterprises and social policy,¹⁰⁵ and the Global Reporting Initiative¹⁰⁶ as appropriate international standards. Provided that a company chooses to rely on one or more of these standards, the documents can inform businesses on what qualifies as *respect for human rights* and *due diligence*. An assessment of the seven standards reveals that few of them instruct companies on non-financial *reporting*.¹⁰⁷ Instead, most of examples rather focus on what companies should *do* about CSR. The UNGPs, for example, provide no guidance on disclosure.¹⁰⁸ The Global Compact, in turn, stipulates only generic reporting requirements. Merely the Global Reporting Initiative offers an actual CSR reporting scheme. Insofar, the reference in the Directive rather stimulates responsible business conduct than CSR reporting.

Focusing on the question of how to respect human rights, the different standards offer a broad range of options. All referenced frameworks (with the exception of EMAS) address the matter of human rights and hence provide - although to a varying extent guidance on how to materialise *respect for human rights* in practice. Most documents draw hereby upon the UNGPs which stand out as the most influential business and human rights agenda. This dominant position principally facilitates a practical understanding of *respect for human*

¹⁰⁰Regulation (EC) No 1221/2009 of the European Parliament and of the Council of 25 November 2009 on the voluntary participation by organisations in a Community eco-management and audit scheme (EMAS), repealing Regulation (EC) No 761/2001 and Commission Decisions 2001/681/EC and 2006/193/EC [2009], Regulation (EC) No 1221/2009.

¹⁰¹United Nations, 'UN Global Compact: The Ten Principles of the UN Global Compact' <<https://www.unglobalcompact.org/what-is-gc/mission/principles>> accessed 24 October 2018.

¹⁰²UN Human Rights Council, 'The United Nations Guiding Principles on Business and Human Rights' (n 13).

¹⁰³OECD, 'Guidelines for Multinational Enterprises' (n 26).

¹⁰⁴International Organization for Standardization, 'ISO 26000 - Social responsibility' (2010) <<http://www.iso.org/iso/home/standards/iso26000.htm>> accessed 12 February 2019.

¹⁰⁵International Labour Organization, 'Tripartite Declaration of Principles concerning Multinational Enterprises and Social Policy' (5th edition 2017) <http://www.ilo.org/wcmsp5/groups/public/---ed_emp/---emp_ent/---multi/documents/publication/wcms_094386.pdf> accessed 12 March 2018.

¹⁰⁶Global Reporting Initiative, 'Standards' <<https://www.globalreporting.org/standards>>.

¹⁰⁷Birgit Spießhofer, 'Die neue europäische Richtlinie über die Offenlegung nichtfinanzieller Informationen – Paradigmenwechsel oder Papiertiger?' [2014] NZG 1281, 1285.

¹⁰⁸As pointed out before, the UN Guiding Principles Reporting Framework aims to fill this gap. However, the schemes of the Framework were only published after the adoption of the CSR Directive. See Business and Human Rights Reporting and Assurance Frameworks Initiative (RAFI), 'UN Guiding Principles Reporting Framework: Guidance Part I: Strengthening Human Rights Reporting and Performance' (2015) <<https://www.ungpreorting.org/framework-guidance/>> accessed 3 November 2018 and Business and Human Rights Reporting and Assurance Frameworks Initiative (RAFI), 'UN Guiding Principles Reporting Framework: Guidance Part II: Assurance of Human Rights Performance and Reporting' (2017) <<https://www.ungpreorting.org/assurance/>> accessed 3 November 2018.



rights in accordance with the UNGPs. Given the dominance of the UN framework, it is not surprising that five of the seven proposed CSR standards (namely, the UNGPs, the OECD Guidelines, the ISO 26000 Standards, the ILO Tripartite Declaration, and the GRI Sustainable Reporting Standards) recommend due diligence as an instrument to address adverse human rights impacts. Based on this comparison, one can reasonably conclude that the Directive promotes HRDD processes as best practice through the back door.

3. Assessment of the regulatory approach

After considering the relevant provisions and their implications on business respect for human rights and due diligence, the inquiry moves on to evaluate the regulatory approach of Directive 2014/95/EU against the benchmarks defined in section II.

Generally speaking, Directive 2014/95/EU is an example of disclosure regulation. This form of governance aims to 'regulate behaviour by enriching the information available to the targeted audience, thereby enabling them to make more informed choices about their behaviour and, it is hoped, to choose to act in a manner that facilitates the attainment of regulatory objectives'.¹⁰⁹ Aside from affecting the choices of the targeted audience such as consumers and investors, disclosure legislation attempts to drive change in two additional ways: depending on the type of information to be disclosed, reporting rules can firstly increase transparency by passing regulatory pressure on along global value chains.¹¹⁰ Secondly, disclosure regulation may trigger change within the reporting entity itself because it necessitates the implementation of processes to gather the demanded information (following the accountancy credo *only what gets measures gets managed*).

On the downside, disclosure regulation is criticised for several reasons. For one thing, the disclosure of information can infringe legally protected interests of other actors such as the right to privacy and business confidentiality.¹¹¹ Furthermore, the approach assumes rational stakeholders that are capable to access, process, and consider the provided information.¹¹² In view of empirical studies, however, the assumption of rational information recipients is rather questionable.¹¹³ Finally, the disclosure of potentially compromising information runs against the inherent interests of a company to avoid liability risks.¹¹⁴ A

¹⁰⁹Bronwen Morgan and Karen Yeung, *An introduction to law and regulation: Text and materials* (Law in context, Cambridge University Press 2007), 96.

¹¹⁰*ibid*, 96 quoting Karen Yeung, 'Government by Publicity Management: Sunlight or Spin?' [2005] Public Law 360 f.

¹¹¹Morgan and Yeung (n 108), 97 quoting Yeung (n 109), 360 f.

¹¹²Morgan and Yeung (n 108), 97 f. quoting Yeung (n 109), 360 f.

¹¹³Morgan and Yeung (n 108), 98 quoting Morgan and Yeung (n 108), 360 f.

¹¹⁴Dániel G Szabó and Karsten E Sørensen, 'Non-financial reporting, CSR frameworks and groups of undertakings: application and consequences' (2017) 17(1) Journal of Corporate Law Studies 137, 162.



reporting business is consequently disincentivised to provide accurate information in view of negative impacts on the interests of others.

Beyond these general remarks on disclosure legislation, the question arises to what extent the Directive facilitates effective self-regulation in the form of HRDD processes. The first benchmark defined in section II is the definition of a clear policy objective. By taking a stand on its purpose, meta-regulation specifies what compliance should ultimately strive for. In the context of HRDD legislation, this end goal is the protection of human rights in the context of business activities. When assessing Directive 2014/95/EU, however, this objective can only be spotted between the lines. Recital 3 holds that ‘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’. Apart from this generic reference to sustainability, the Directive does not explicitly target any of the six CSR topics listed in Article 19a (1) – thus, environmental, social and employee matters, anti-corruption and bribery issues and respect for human rights. Instead, the act reasons on behalf of the recipient of non-financial information. In fact, recital 3 recognises ‘the needs of investors and other stakeholders [for non-financial information] as well as the need to provide consumers with easy access to information on the impact of businesses on society’. Similarly, recital 6 defines the aim ‘to enhance the consistency and comparability of non-financial information disclosed throughout the Union’. The right quantity and quality of CSR information surely is an important interim goal as it facilitates stakeholder engagement. Ultimately, however, stakeholder engagement is not an end in itself, but only one mean to facilitate eventually substantial objectives such as business respect for human rights. Lacking a clear commitment to CSR objectives, the Directive does not set the direction of the processes it intends to stimulate. On the contrary, it creates an incentive to tick boxes rather than engagement in effective HRDD processes.

The second challenge of meta-regulation is to nudge companies to design internal structures and management processes that consider the matter of adverse human rights impacts. In that respect, Directive 2014/95/EU draws a torn picture. On the one hand, it *de facto* requires reporting entities to establish processes to gather information on their human rights risks and impacts. On the other hand, the risks and impacts in the global supply and subcontracting chains – which often pose the real challenge – must only be identified where companies deem it ‘relevant and proportionate’. As pointed out before, this reservation poses the risk of an opportunistic interpretation on the part of the businesses. A potential way out would be to clarify what qualifies as relevant and proportionate in the context of globalised CSR risks. This could be done by means of a legal reform or a clarification by the European courts.



With respect the second, third, and fourth step of HRDD, there are limited regulatory incentives or pressure to establish effective internal processes. While the comply or explain rule ensures transparency whether a company takes action at all, there are insufficient safeguards to assure the quality of these measures. In short, Directive 2014/95/EU provides only limited incentives for companies to implement appropriate due diligence processes. In addition, the act does not facilitate learning cycles and revaluations to enhance the effectiveness of CSR measures over time. In theory, a company could perfectly comply with the Directive by reporting word-by-word about the very same policies year after year. This could be prevented by adding a mandatory section to the non-financial statement which describes exclusively all changes of circumstances and resulting policy adjustments. On a different note, the Directive's involvement of stakeholders is insightful. On the one hand, the act provides stakeholders with additional non-financial information that allow civil society organisations, consumers, and investors to take better informed decisions. On the other hand, the law does not include stakeholders in course of the mandatory risk characterisation (Article 19a (1) (d)). Requiring companies to consider complaints and grievances of relevant stakeholders, however, would be mutually beneficial. This would ease the task for companies to collect the necessary data, improve the credibility of the non-financial information, and give those people a voice that are negatively affected by a company's activities.

Finally, a meta-regulatory approach to HRDD legislation grants companies leeway to tailor their compliance strategy to their business context. In other words, companies need a margin of appreciation within the flexibilities inherent in the HRDD process. By combining mandatory reporting rules with comply or explain provisions, the Directive offers companies a broad network of avenues with many pathways of compliance. First of all, a reporting entity can choose whether or not to engage in respect for human rights at all. Provided that it opts to address the matter, it can report about its engagement either on the basis of a recognised CSR standard or on its own terms. If a company chooses to rely on a CSR standard, it is spoilt for choice between various frameworks with different methodologies and approaches. Only if a reporting entity selects and applies a standard that recognises and builds upon the UNGPs, it may implement HRDD processes. At each of these junctions, a company is free to take one way or the other. Insofar, Directive 2014/95/EU grants companies a high degree of flexibility to define their own approach in line with their business model.

By contrast, the downside of the Directive's approach rather concerns the lack of sufficient boundaries that limit the corporate leeway described. This is because the act only distinguishes between those companies with and without a specific CSR policy. Whether



these measures are adequate, in turn, is not taken into account. Only the total absence of a human rights policy requires an explanation and bears a real risk of reputational damage resulting from the distrust of consumers and investors. A poor human rights policy lacking effective HRDD processes, on the other hand, is much less exposed to stakeholder critique. Although the disclosure of such a policy allows investors or NGOs to identify and condemn shortcomings, it is much more difficult to argue that a policy is insufficient because the Directive does not define any absolute standard that would serve as a point of reference.

To remedy this shortcoming the Directive would need to define substantial boundaries regarding the quality of a human rights policy. This could be done by requiring information directly on the due diligence processes applied. In combination with a comply or explain rule, this would incentivise specifically the implementation of HRDD processes. In addition, the Directive should refer companies only to those CSR standards that provide sufficient guidance on due diligence. These changes would not challenge the principle leeway of companies as they could still opt against HRDD processes. In its current form, however, Directive 2014/95/EU grants the flexibility not to engage in HRDD at all. In the absence of incentives to adopt all four steps of a HRDD processes, the company's choice is solely determined by its level of human rights engagement.¹¹⁵ The level of engagement, in turn, is subject to the forces of the market.¹¹⁶ To subject respect for human rights to market conditions, however, is a sign of normative destitution.

IV. Concluding remarks

In sum, the meta-regulatory approach reveals a couple of flaws in Directive 2014/95/EU which call for legal reform. For one thing, the act should clearly define respect for human rights as a substantial policy objective. Besides, several aspects of the Directive demand further specification. While the requirement to disclose human rights risks and impacts marks an important step, it is not specified under what conditions risks in the global supply and subcontracting chains are 'relevant and proportionate'. Furthermore, the importance of stakeholders in the course of due diligence processes should be strengthened. Most importantly, however, a reformed Directive should provide sufficient incentives to reward high-quality human rights management rather than lip service. This could be achieved by requiring the disclosure of a company's HRDD processes instead of or in addition to its general human rights policies. Combined with a comply or explain clause, this would incentivise the implementation of best practice instead of any arbitrary policy. Moreover, the Directive should refer companies only to a limited set of CSR standards (such as the

¹¹⁵Ahern (n 76), 610.

¹¹⁶ibid, 612.



UNGPs, the OECD Guidelines, or the Global Reporting Initiative standards) that recognise due diligence as the state of the art.

Overall, Directive 2014/95/EU is only one piece of disclosure legislation which makes it necessary to place it in the broader regulatory context. According to the UNGPs, states should ‘consider a *smart mix* of measures – national and international, mandatory and voluntary – to foster business respect for human rights’.¹¹⁷ Thus, the implementation of effective HRDD processes must be pursued through a combination of measures. The EU has principally adopted this *smart mix approach*. In its latest policy on CSR from 2011, the European Commission states that ‘CSR should be led by enterprises themselves’ while the legislator ‘should play a supporting role through a *smart mix* of voluntary policy measures and, where necessary, complementary regulation’.¹¹⁸ Against this background, my research project attempts to consider the bigger picture. For that purpose it draws additionally on other examples of EU and European national law, namely, Regulation (EU) 2017/821 and the French Duty of Vigilance. On the basis of a broad assessment, I intend to answer the question whether the HRDD approach in European legislation is fit for the purpose of addressing business-related human rights abuses.

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¹¹⁷UN Human Rights Council, ‘The United Nations Guiding Principles on Business and Human Rights’ (n 13), 5 (emphasis added).

¹¹⁸European Commission, ‘Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions: A renewed EU strategy 2011-14 for Corporate Social Responsibility’ (COM(2011) 681 final, 25 October 2011) 7 (emphasis added); Elsewhere in the renewed strategy, the EC reiterates this approach for external EU action. Accordingly, it intends to apply ‘a mix of global advocacy and complementary legislation, to aim at disseminating internationally recognised CSR guidelines and principles more widely and enabling EU businesses to ensure that they have a positive impact in foreign economies and societies’ (page 14).



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