US Cos. Must Prepare For EU Human Rights And Climate Policy

By **David Lakhdhir and Mark Bergman**

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Almost a decade has passed since the United Nations Human Rights Council endorsed its Guiding Principles on Business and Human Rights,[1] and the Organization for Economic Cooperation and Development updated its Guidelines for Multinational Enterprises to add a new chapter on human rights.[2] Over five years have passed since the signing of the Paris Agreement on climate change.[3]

During the intervening years, companies have been encouraged to conduct their businesses in accordance with the U.N. guiding principles and the OECD guidelines, and to reduce their carbon outputs in line with the targets set out in the Paris Agreement. To date, compliance has been voluntary. As a result of legal developments in Europe, that appears likely to change.

On Jan. 27, the Legal Affairs Committee of the European Parliament voted to adopt a report[4] that calls on the European Commission to propose a directive that would obligate subject companies to identify, address and remedy aspects of their own operations, supply and distribution chains, and investments that could or do impinge on human rights or adversely affect the environment — including climate change.

The directive, which would not be self-executing, but instead would be transposed into national laws in each of the European Union's 27 member states, would apply not only to companies that are organized or headquartered in the EU, but also to all large companies or corporate groups that access the EU internal market.

The Legal Affairs Committee proposed that the directive provide for reparations for victims of serious human rights abuses, and the imposition of fines, unless the accused company can demonstrate that it has acted in line with due diligence obligations and taken measures to prevent the abuses. It also called for a ban on importing products into the EU the manufacture of which is linked to severe human rights violations, such as forced or child labor.[5]

The European Parliament is expected to endorse the committee's report in the coming weeks. The European Commission, which is already working on this initiative on a parallel track,[6] is expected to present a draft directive later this year.

These laws may present significant challenges to U.S. companies with material operations or investments in Europe. They may also present challenges to the Biden administration, which will have to decide how the U.S. should respond to these European legal developments.

Due Diligence and Disclosure Laws

European Parliament and European Commission actions come against a backdrop of similar initiatives in individual EU member states, the U.K. and Switzerland.

In 2017, France adopted a so-called vigilance law,[7] which applies to companies headquartered in France — including French subsidiaries of U.S. companies — that have, together with their subsidiaries, at least 5,000 employees in France, or 10,000 employees worldwide. Companies subject to the law are required to establish and effectively implement due diligence measures to identify and prevent human rights violations and environmental damage.

In 2019, the Dutch Senate passed the Child Labor Due Diligence Act, which requires companies to identify and prevent the use of child labor in their supply chains.[8] The act, which is expected to come into effect in 2022, applies to all companies, including foreign companies, that supply goods or services to end users in the Netherlands.

Violations of the act can result in administrative fines, and recurrent violators can be subject to criminal prosecution. The Dutch government is also contemplating legislation to mandate human rights due diligence for supply chains, and not just for child labor,[9] although this initiative may be overtaken by the EU directive.

In Switzerland, the Responsible Business Initiative did not receive the requisite multicantonal support in a November 2020 referendum, but a less stringent government proposal, expected to come into force in 2021, will impose reporting duties in relation to human rights, environmental, social, anti-corruption and employment-related matters, as well as additional due diligence and transparency duties with regard to conflict minerals and child labor.[10]

In the U.K., the Modern Slavery Act[11] requires companies to issue an annual statement on the steps taken to ensure that slavery and human trafficking are not taking place in their own businesses or supply chains. In September 2020, the U.K. government published its response to a consultation on the supply chain reporting requirement,[12] which, when implemented, will significantly increase the volume and specificity of information that companies will be required to include in their statements.

The EU Non-Financial Reporting Directive, or NFRD,[13] already requires companies listed in the EU to report on the policies they have implemented in relation to environmental protection, social responsibility, the treatment of employees and respect for human rights.

In 2019, the European Commission published guidelines on reporting climate-related information,[14] which augmented the disclosure requirements in the NFRD. The commission is expected to broaden the categories of companies subject to the NFRD's requirements, and to increase the information required to be disclosed.

Impact on U.S. Companies and Investment Funds

If the EU directive is adopted in the form proposed by the European Parliament, many U.S.-headquartered multinationals, and possibly many U.S. private equity funds, will become subject to due diligence and reporting requirements under legislation to be adopted by each of the EU member states. These requirements will go significantly beyond those currently in place in the U.S.

To date, the U.S. Securities and Exchange Commission has not required reporting companies per se to disclose information concerning human rights or climate change risks. Although there are limited disclosure requirements under other provisions of the federal securities laws in respect of specific related issues — Iran-related activities,[15] conflict minerals[16] and payments by resource extraction issuers[17] stand out as examples — there is no requirement to disclose corporate or supply chain activities that may give rise to human rights abuses, and/or corporate policies that have been implemented to identify and prevent abuses.

The same is true for climate change risks. In August 2020, when the SEC amended Regulation S-K, it explicitly declined to include climate risks as a mandated disclosure item.[18]

Some states — most notably, California — have enacted laws that require limited disclosures of selected human rights issues. The California Transparency in Supply Chains Act requires large retailers and manufacturers doing business in California to disclose on their websites their "efforts to eradicate slavery and human trafficking from [their] direct supply chain for tangible goods offered for sale."[19]

In 2019, bills were introduced in both the U.S. Senate[20] and the U.S. House of Representatives[21] that would require public companies to disclose to shareholders certain environmental, social and governance metrics and their connection to the long-term business strategy of the issuer. But action on these matters does not require legislation. The SEC would be able to promulgate enhanced disclosure requirements in relation to human rights and/or climate change without further legal authority — and there are reports that this is on the Biden administration's agenda.

When it comes to U.S. laws that might impose direct liability on companies for serious human rights violations overseas, the U.S. Supreme Court has in recent years significantly limited the potential liability of non-U.S. companies[22] under the Alien Tort Statute.[23] It is currently considering to what extent the statute may be invoked against a U.S. corporate entity for aiding and abetting conduct overseas.[24]

If the Supreme Court decides that U.S. companies are not subject to liability under the Alien Tort Statute, U.S. multinationals may soon discover that while they are safe from these suits in U.S. courts, they are exposed to potential liability under the laws of EU member states.

Implications for Companies and Investors

For companies that already have strong, voluntary ESG monitoring, compliance and reporting programs, these developments in Europe should not present a major burden — and indeed may be welcome, as less ethical competitors will be forced to fall into line.

Companies that have so far not implemented a strong ESG programs and have significant European operations, and/or operate in sectors that are particularly exposed to human rights-related risks in their operations or supply chains, should move quickly to assess their potential risk exposure, and implement an internal review process that is tailored to their industry, geographic footprint, supply chain configuration, reputational risk profile and other relevant factors.

U.S. reporting companies should assume that the SEC will, in the Biden administration, require issuers to make significant disclosures with respect to both climate change risks and human rights compliance. Because of the significant potential liability and risk of suits that would be associated with material misstatements or omissions in those reports, these reporting obligations could impose a de facto duty to engage in due diligence in respect of matters covered by the reporting obligation.

Broader Implications

Disclosure and related due diligence obligations can be useful tools to encourage ethical corporate behavior, in international operations and supply chain management, as well as in relation to corporate efforts to address climate change. To achieve that goal, but avoid disproportionate administrative burden, the disclosure requirements need to be clear, realistic and targeted at standardized data and metrics.

The SEC has an opportunity to promulgate sensible rules that elicit meaningful disclosure and encourage ethical corporate behavior, while avoiding a one-size-fits-all rule that merely gives rise to a box-ticking exercise that increases costs but adds little value.

In doing so, the SEC may wish to look at the European experience. The Biden administration may also wish to coordinate with the European Commission, to harmonize these requirements, so that companies that are subject to both U.S. and EU legal requirements — of which there may be many — are not subject to inconsistent or inefficiently duplicative compliance requirements.

Providing opportunities for the victims of serious human rights violations to seek justice through judicial or other mechanisms serves both as an effective deterrent, and as a means of providing redress to the victims. Little is served, however, by laws that lack clarity, and may subject companies to suit in multiple jurisdictions under vague or ambiguous standards.

The Biden administration should engage with the European Commission to ensure that if companies doing business in the EU are to be held liable for violations of human rights, the standards for imposing liability are clear and realistic, and are designed to provide companies with an ability to mitigate the risk of violations through the adoption of effective compliance programs, and — while providing meaningful remedies for serious violations — to reduce the risks of unmeritorious claims or multiple parallel proceedings.

The EU appears likely to adopt significant mandatory measures designed to achieve the goals set out in the guiding principles and the Paris Agreement. U.S. companies and investors, as well as policymakers and regulators in the new Biden administration, should take note of these developments, and take action to avoid being caught unprepared.

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[1] The U.N. Human Rights Council endorsed the Guiding Principles in its resolution 17/4 of June 16, 2011.

[2] The updated Guidelines were adopted by the 42 adhering governments on May 25, 2011.

[3] The Paris Agreement has been signed by 194 countries and the European Union, and entered into force on Nov. 4, 2016.

[4] Committee on Legal Affairs, "Draft Report with recommendations to the Commission on corporate due diligence and corporate accountability" (Sept. 11, 2020, as amended Oct. 9, 2020).

[5] EU Parliament Press Release, "MEPs: Hold companies accountable for harm caused to people and planet" (Jan. 27, 2021).

[6] See European Parliament Briefing, "Towards a mandatory EU system of due diligence for supply chains" (Oct. 2020).

[7] See Loi no. 2017-399 du 27 mars 2017 relative au devoir de vigilance des sociétés mères et des entreprises donneuses d'ordre.

[8] Eveline van Rhijn, "The possible impact of the Dutch Child Labor Due Diligence Act" (Jan. 31, 2020).

[9] Social and Economic Council, "Working together for Sustainable Supply Chain Impact" (Sept. 2020).

[10] Initiative populaire "Entreprises Responsables."

[11] Modern Slavery Act 2015.

[12] UK Home Office, "Transparency in supply chains: Government response" (Sept. 22, 2020).

[13] Directive 2014/95/EU (Oct. 22, 2014).

[14] "Guidelines on non-financial reporting: Supplement on reporting climate-related information" (June 20, 2019).

[15] See Notice required by the Iran Threat Reduction and Syria Human Rights Act of 2012 (Dec. 19, 2012).

[16] See Fact Sheet: Disclosing the Use of Conflict Minerals (March 14, 2017).

[17] See SEC Release No. 34-90679, "Disclosure of Payments by Resource Extraction Issuers" (Dec. 16, 2020).

[18] See SEC Release No. 33-10825, "Modernization of Regulation S-K Items 101, 103, and 105" (Aug. 26, 2020). The statements of SEC Commissioners Lee and Crenshaw objected to the failure of the final amendments to address climate risks (and diversity issues).

[19] See also the resource guide issued by then-California Attorney General Kamala Harris.

[20] S.2075, Climate Risk Disclosure Act of 2019.

[21] H.R.4329, ESG Disclosure Simplification Act of 2019.

[22] Jesner v. Arab Bank PLC, 138 S. Ct. 1386 (2018); Kiobel v. Royal Dutch Petroleum, 569 US 108 (2013).

[23] 28 USC. § 1350.

[24] Nestle v. John Doe 1, et al.