MINISTRY OF INDUSTRY, BUSINESS AND FINANCIAL AFFAIRS

NOTE

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Annex on the initiative on mandatory corporate due diligence

The Danish Government welcomes the European Commission's initiative to introduce a legislative proposal on mandatory due diligence that encourages sustainable and responsible business conduct globally by contributing to an efficient smart mix of mandatory and voluntary measures.

COVID 19 has shown that in order to manage crises effectively and flexibly, companies are well advised to have a close understanding of their value chains, know their suppliers and cooperate with them to address any adverse impacts and vulnerabilities.

Definition of due diligence

The term due diligence should be used in accordance with the risk-based due diligence concept developed by the United Nations (UN) Guiding Principles on Business and Human Rights (UNGPs) and OECD's Guidelines for Multinational Enterprises as revised in 2011.

Risk-based due diligence is a process to identify, prevent, mitigate and account for harmful impacts caused by the company, or to which the company contributed, or impacts that are directly linked to its operations, products or services by its business relationship with another entity. Risk-based due diligence is characterized as a management approach. It should be an ongoing and contextual process that involves stakeholders, in particular those affected by the risk.

The Danish Government will draw attention to the importance of due diligence not becoming a tick-box exercise. The Commission can carefully consider how to obtain the intended objectives of due diligence without causing a shift from identifying and preventing harm on the ground through a management process on to compliance with a statutory requirement; and involve socio-legal expertise with knowledge of regulatory strategies on organisational change to help provide input for this purpose.

Related regulation

Some EU regulation regarding risk-based due diligence is already in place such as the EU Conflict Minerals Regulation, the NFRD Directive, the Disclosure Regulation, and the standard setting Taxonomy Regulation. It is therefore important to ensure that new regulation does not conflict or overlap with existing legislations.

In Denmark, mandatory reporting on corporate social responsibility (CSR) was introduced with effect from the financial year 2009 through an amendment to the Act on Financial Accounts.

In 2012, the Danish legislature adopted an Act that provided the Danish OECD NCP with a statutory basis. According to the NCP Act, NCP Denmark is an independent body within the public administration. It comprises five members, including three appointed based on nominations from industry, labour unions and civil society. A secretariat is provided by the Danish Business Authority.

An EU legal framework

The Danish government acknowledges that mandatory EU due diligence can contribute effectively to a more sustainable development, including in non-EU countries. A harmonization in this area will reduce regulatory fragmentation between Member States and additional administrative burdens for the companies, as emerging national laws in this field are quite different.

On the other hand, an EU legal framework can lead to possible risks. An EU legislation on due diligence must be aware not to cause:

- Disproportionate administrative costs and procedural burdens
- Penalization of smaller companies with fewer resources
- Competitive disadvantage vis-à-vis third country companies not subject to a similar duty
- Responsibility for damages that the EU company cannot control
- Disengagement from risky markets, which might be detrimental for local economies

The UNGPs and OECD's Guidelines set out the aim for companies to identify and manage risks, ultimately and ideally to avoid harm. This presumes an ongoing and contextual process suited to the dynamic character of the risk in question. We recommend the Commission to be mindful that due diligence as a legal standard of conduct may involve that due diligence processes must be standardised risking to reduce the flexible, dynamic and risk-based characteristics of the UNGP and OECD Guidelines' due diligence concept.

Yet, without a legal standard of conduct for companies' due diligence processes it will be difficult to deliver legal certainty for companies regarding societal expectations or potential sanctions, or to ensure a level playing field between companies. However, defining due diligence as a standard of conduct might shift companies' focus towards compliance with that standard. This might detract from their efforts to effectively identify and manage risks through an ongoing and contextual process. Evidence of

company actions and responses to increasingly detailed requirements on non-financial reporting suggests that detailed requirements and penalties may enhance compliance orientation at the cost of effective contextual due diligence. The Commission should be mindful of the risk that EU legislation results in a mere tick-the-box exercise for companies with no real impact. This means considering whether a standard of conduct will deliver better protection for the violated part than a requirement about a management process.

With the aim to introduce harmonized EU regulation the Danish Government initially considers positively a horizontal due diligence regulation that is cross-sectorial and cross thematic, covering human rights, social and environmental matters and are in line with both UN Guiding Principles on Business and Human Rights, the ILO Tripartite Declaration of Principles concerning Multinational Enterprises and Social Policy and the OECD Guidelines for Multinational Enterprises.

The horizontal regulation is preferable because many problems are not limited to one sector or theme and it is often not possible to deal with them in isolation. Where necessary the horizontal regulation could be complemented by EU-level general or sector specific guidance or rules like the Timber Regulation.

The Danish Government highlights that the initiative will have to find a balance between flexibility and precision.

Scope of the due diligence legislation

Many European companies are part of global supply chains and engage in business operations outside of the EU. It is therefore key that any legislative framework in the EU takes an international perspective in order not to compromise the competitiveness of European companies and avoid losing global market shares to companies that are not met by the same requirements and are not upholding the same standards.

Regulating only the largest companies, requirements will still trickle down the value chains and affect many smaller companies as well. It is therefore recommended to use a step-by-step approach and start with the largest companies, while we collect knowledge and experience for mandatory requirements for the largest companies before potentially expanding to smaller companies.

Mandatory requirements to a simplified standard for SMEs would be an ambitious goal in the long term, but in the short term a voluntary solution accompanied by SME specific guidance is considered the optimal solution in order to collect experiences and best practice. Regulation should be developed with respect to the resources available for small and medium size

companies. SMEs should have detailed non-binding guidelines catering for their needs.

SME´s are not familiar with due diligence procedures to the same extent as larger companies among other reasons because they are not covered by NFRD requirements. It is important that proportionality principles take this fact into account and that considerations are made regarding a special system for the SME´s. The level of risk assessment should play a crucial role in these considerations.

Consideration needs to be given to the practical challenge companies could face to comply with legislation, including overview of large and complex supply chains and how to handle subcontractors with which the company does not have a direct relation. This is also in line with the OECD Guidelines, where leverage and responsibility go hand in hand.

Enforcement mechanism and sanctions

It is crucial that there is a realistic possibility of carrying out the control necessary to ensure real impact of the rules. In addition, the role of sanctions must be considered in more detail, because financially burdensome sanctions in the form of compensation must be proportionate to the breach of the obligations.

It is essential that affected stakeholders (victims) have the required resources to carry out a claim. Moreover, to obtain a compensation a legal standard of conduct would also be required so that the company's due diligence can be assessed and found adequate or deficient. However, it is still important to keep in mind, that risked-based due diligence is an on-going dynamic process and must therefore not be a thick-the-box exercise.

In general, the general aim of regulation and enforcement is not to oblige companies to compensate victims in individual cases. This means that private enforcement still has an important role to play, holding companies liable under tort law for the harmful effects of human rights violations.

Access to Remedy

Access to remedy for risks that occur in host countries as a result of the activities of multinational enterprises is often restricted due to the jurisdictional limits of national courts. As home state courts typically cannot deal with issues occurring in host states or along the supply chain in third countries, affected stakeholders need to apply for remedy with institutions in their own country. Weak institutions, law and/or enforcement in host states can make access to courts difficult or ineffective for affected stakeholders in those countries.

The present system on due diligence is voluntary and is based primarily on the UN Guiding Principles for Responsible Business Conduct and OECD's Guidelines for multinational enterprises. Part of the OECD Guidelines is the establishment of the NCP system, where the national contact points (NCP´s) are intended to raise awareness of the OECD Guidelines and to establish a complaint-handling system where everyone has the opportunity to file a complaint concerning a company that does not carry out due diligence as mentioned in the guidelines. An essential element of the system is a mediation function. In addition, the NCP's can make statements, including criticisms, in connection with the company's compliance with OECD guidelines, as well as make recommendations in this regard. There is no possibility of the NCP awarding financial compensation to the complainant.

The Danish NCP is renowned for being law-based, for including both private companies and public institutions and for providing opportunities to take up cases on the NCP´s own initiative. Central parts of the Danish system are the task of creating awareness of the OECD Guidelines, the broad and simple right of complaint with no fee and a simple complaint procedure, the use of alternative solutions based on dialogue and mediation and the opportunity to give criticism and recommendations which are published on the NCP´s website. Based on experience the Danish NCPs involvement in specific cases and its recommendations often help the companies to develop their due diligence processes. Therefore, the promotional tasks, complaint procedures, mediation possibilities and publishing of criticism and recommendations should be preserved in a new system on due diligence.

The Danish Government recommends the Commission to consider learnings from the OECD NCP system regarding access to non-judicial remedy and we would be pleased to exchange experience from the Danish law-based NCP. The NCP system has a unique possibility of granting affected stakeholders access to remedy due to the extraterritorial competence and the conflict-solving approach. It secures access to justice and is less costly than a judicial system.

Stakeholder engagement

In the due diligence processes, it is important to engage relevant stakeholders. The UNGP and the OECD guidelines use the expression "affected stakeholders". That is to be understood as persons that are or can be directly affected by adverse impacts in which case, they will become victims or violated. This is relevant both in the process of identifying the risks and in process of investigating whether the risk has been handled in a responsible manner.

The Danish Government recommends the Commission to clearly define the roles of stakeholders in order to improve legal certainty for companies.

Summing up it appears important to combine the aims of legal certainty, level playing field, enforcement and victims' access to (substantive) remedy with civil claims and equality of arms that appear to presume a legal standard of conduct, with due diligence as a risk management process and the aim of companies not causing harm. Due diligence must not become a tick-box exercise. This is in accordance with the idea of due diligence as a management process that is ongoing, contextual and fit to identify risks that may be subject to dynamic change.