



Enforcing **due diligence** legislation 'plus'

Duncan Brack and Saskia Ozinga
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Authors: Duncan Brack and Saskia Ozinga

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The purpose of this report is to recommend the optimum design of European Union level due diligence legislation for forest risk commodities to ensure its effective enforcement. The recommendations are based on assessing the effectiveness of existing due diligence legislation, in particular the EU Timber Regulation (EUTR), through a literature review and interviews and discussions with non-governmental organisations (NGOs), competent authorities and others.

We discuss both the design of the legislation and key characteristics of its compliance and enforcement systems that are important but may not be specified in the legislation (often because they fall outside areas of exclusive EU competence). This report reflects our current thinking, but further research, analysis and discussion would be welcome and will be required to reach more final conclusions.

Two EU processes are currently under way that may lead to due diligence legislation affecting forest risk commodities, or companies handling them, but the outcomes are not yet known. It seems clear that Directorate General (DG) Justice will come forward with a proposal for broad corporate – ‘horizontal’ – legislation placing an obligation on companies to exercise due diligence with regard to human rights abuses and environmental harm throughout their operations and supply chains.

It is possible, though not certain, that DG Environment will publish a proposal for due diligence legislation for a defined list of forest risk commodities, which may include provisions relating to the placing of these commodities on the EU market. For the purposes of this report, we assume that both pieces of legislation will be introduced, in line with NGO recommendations that make the case for this combination of legislative instruments.

One of the challenges of discussing the appropriate design of due diligence legislation and its enforcement is that two different concepts of due diligence lie behind the current debate, and they are often confused. The emergence of the two different pieces of EU legislation offers the opportunity to put both into practice. Section 2 of this paper briefly summarises the two approaches.

Section 3 summarises lessons from relevant existing legislation, particularly the EUTR, since it deals with a forest risk commodity (timber). Section 4 draws on these lessons to propose ways in which each type of due diligence legislation can be most effectively enforced. Section 5 summarises our conclusions.

This is a rapidly evolving debate, and it would benefit from much greater consideration and more evidence of the impacts, positive and negative, of existing legislation. The proposals should therefore not be treated as final and may need to be modified or further developed.



Due diligence approaches

The idea of 'due diligence' can be traced as far back as Roman times. Originally a legal concept applying to individuals – reasonable steps taken by a person in order to avoid committing an offence – it is increasingly being applied to businesses, particularly with regards to the impact or potential impact of companies' operations and supply chains on the environment, human rights and labour rights.

The due diligence concept is now present in EU legislation on money laundering, hazardous substances, food safety, genetically modified foods and crops, illegally sourced timber and conflict minerals, and also in national legislation in several EU Member States.

Outside these areas, many businesses also already employ due diligence approaches on a voluntary basis. In a detailed study conducted for the European Commission, just over a third of business respondents indicated that their companies were undertaking due diligence with respect to all human rights and environmental impacts, and a further third were undertaking due diligence limited to certain areas¹ (survey respondents were self-selected, so this is unlikely to be representative of business as a whole).

What is meant by 'due diligence', however, is not always clear. Two different concepts affect the current debate: due diligence as a continuous process of improvement; and due diligence as a process that is undertaken before a decision is made, or a product is permitted to be placed on the market.

2.1 Due diligence as a continuous process of improvement

The idea of due diligence as a continuous process of improvement derives mainly from the United Nations (UN) *Guiding Principles on Business and Human Rights* agreed in 2011. These describe the responsibility of companies to respect human rights (both to avoid infringing the rights of others and to address adverse impacts that occur) and the need for both states and businesses to strengthen access to appropriate and effective remedies for victims of business-related human rights abuses.²

The Guiding Principles state explicitly that business enterprises should carry out ‘human rights due diligence’ to ‘identify, prevent, mitigate and account for actual or potential adverse human rights impacts a company may be involved in through its own activities or business relationships’. Potential impacts should be prevented, while actual impacts—those that have already occurred – should be subject for remediation.

After the Guiding Principles were published, the Organisation for Economic Cooperation and Development (OECD) revised its *Guidelines for Multinational Enterprises* accordingly,³ and in 2018 published its *Due Diligence Guidance for Responsible Business Conduct*.⁴ This essentially adopts the same approach as the Guiding Principles, but widens the criteria on which it suggests due diligence should be exercised to cover human rights, employment and industrial relations, environment, bribery and extortion, consumer interests, and disclosure of information. The due diligence framework it sets out is intended for use by enterprises to avoid and address adverse impacts in their operations, supply chains and business relationships.

The due diligence approach is also reflected in the OECD – Food and Agricultural Organisation (FAO) *Guidance for Responsible Agricultural Supply Chains* published in 2016. This Guidance includes a framework for risk-based due diligence along agricultural supply chains; a model enterprise policy outlining the standards that enterprises should observe in building responsible agricultural supply chains; a description of the major risks faced by enterprises and the measures to be taken to mitigate these risks; and guidance for engaging with Indigenous Peoples.⁵ The criteria it suggests for the model enterprise policy include human rights, labour rights, health and safety, food security and nutrition, tenure rights over and access to natural resources, animal welfare, environmental protection and sustainable use of natural resources, governance, and technology and innovation.

The formalisation of requirements to practice human rights due diligence has also been central to ongoing negotiations on a new UN treaty on business and human rights. The latest draft of the treaty spells out that states should adopt a regulatory

¹ Lise Smit et al (British Institute of International and Comparative Law, Civic Consulting and London School of Economics and Political Science, Study on *Due Diligence Requirements Through the Supply Chain* (European Commission, January 2020).

² Office of the UN High Commissioner for Human Rights, *Guiding Principles on Business and Human Rights: Implementing the United Nations « Protect, Respect and Remedy » Framework* (UNOHCR, 2011).

³ See <https://www.oecd.org/corporate/mne/>.

⁴ OECD *Due Diligence Guidance for Responsible Business Conduct* (OECD, 2018).

⁵ OECD – FAO *Guidance for Responsible Agricultural Supply Chains* (OECD, 2016).

framework imposing human rights due diligence in companies, backed by the threat of effective sanctions.⁶ Interestingly, this draft defines ‘human rights’ not as limited to those human rights recognised in the most widely accepted international instruments, such as the International Bill of Human Rights and International Labour Organisation (ILO) core conventions; it includes ‘environmental rights’ and requires that assessments include environmental impacts.⁷

These UN and OECD documents recognise that due diligence is a dynamic, ongoing process. Companies are not expected to be able to solve all problems immediately; they should prioritise the risks they address, deal with the highest risks and the most severe impacts first and steadily improve their performance. As the OECD Guidance expresses it :

*The due diligence process is not static, but ongoing, responsive and changing. It includes feedback loops so that the enterprise can learn from what worked and what did not work. Enterprises should aim to progressively improve their systems and processes to avoid and address adverse impacts.*⁸

This due diligence concept is the type that underlies the French Devoir de Vigilance law, described in Section 3.3, and other national initiatives including the Dutch Child Labour law and the proposed Swiss due diligence law.

One of the potential risks of this due diligence approach is that companies may seek to satisfy the criteria by simply abandoning high-risk suppliers or regions (assuming they can source the products elsewhere), rather than work with them to clean up their supply chains; as a result, suppliers may simply switch to sell to less scrupulous buyers without changing their practices. There is also a particular risk to small-holders, as buyers may tend to drop them in the belief that they may find it more difficult to demonstrate compliance with the criteria. The Guiding Principles accept that if a company lacks leverage to either prevent human rights abuses or provide remediation, it should consider ending the relationship with the suppliers in question. The same language is included in the Guidance for Responsible Agricultural Supply Chains. The OECD *Guidance for Responsible Business Conduct* suggests that disengagement from suppliers should be considered only as a last resort after attempts at preventing or mitigating severe impacts have failed – implying that the company should be allowed some time to work with these suppliers to clean up their performance.⁹

Another risk is that a due diligence approach could end up simply as a box-ticking exercise, without any real impact on companies’ behaviour. To some extent this appears to be happening with the UN Guiding Principles, which have had a huge reach but a much less clear impact on the ground. The Guidelines are based on the idea

⁶ Article 6.2

⁷ Paul Hastings, ‘*The EU Human Rights Due Diligence Legislative initiative and the Business and Human Rights Treaty*’, September 2020; available [here](#).

⁸ OECD *Due Diligence Guidance for Responsible Business Conduct*, p. 17.

⁹ *ibid.*, pp. 30, 80.

of ‘knowing and showing’ rather than ‘naming and shaming’, but transparency and harmonised reporting processes are still largely lacking, thus allowing companies to simply ‘tick the boxes’ by putting systems in place without analysing whether they are achieving anything. Depending on how the legislation is written, putting in place the due diligence system but doing little or nothing to apply it may also allow the company to avoid liability for any harm occurring as a result of its failure to exercise due diligence in the absence of specific liability requirements (see further in Section 3.3).

The UN and OECD documents are written to provide guidance to enterprises. They do not in themselves consider issues of the enforcement of legislation that requires enterprises to exercise due diligence, including how enforcement agencies, or courts, can decide whether or not companies have exercised due diligence, or exercised sufficient levels of due diligence.

2.2 Due diligence as a market obligation

The other due diligence concept relates to a process that must be carried out before a decision is made or an action carried out. This is common particularly in the world of finance and investment and is generally present in legislation governing the duties of financial agents. In this context, due diligence is the detailed investigation carried out by or for a potential investor on the company and/or project that may be invested in. It includes actions such as scrutinising financial records, past company performance and risks that the investment may not generate the projected returns. It may lead to the investor changing their mind over their potential investment or negotiating additional terms and conditions.

Similarly, due diligence is a central part of legislation dealing with money laundering, placing requirements on the staff of the institutions handling money to carry out effective customer due diligence. This may be as simple as identifying customers and checking they are who they say they are. Where the risk of money laundering is assessed as high, stricter procedures must be followed, including, for example, obtaining additional identification information from the customer, together with information on the source of funds or source of wealth, the intended nature of the business relationship and the purpose of the transaction.

Based on this process, financial institutions may be required to submit a suspicious activity report to the authorities if they suspect something in a transaction is illegal. If they have not carried out this process, or if they have carried it out and not submitted a suspicious activity report where something might have been illegal, they can be prosecuted.

This due diligence concept is the type that underlies two of the pieces of legislation analysed in Section 3: the EU Timber Regulation and the EU Conflict Minerals Regulation. In each case companies placing timber products, or four specified minerals, on the EU market, are required to exercise due diligence to avoid placing illegal timber, or conflict minerals, on the market.

This type of due diligence clearly differs from the more gradual approach described above in Section 2.1. Applied to forest risk commodities it would be designed to exclude products not meeting particular criteria – perhaps legality, or sustainability, or zero-deforestation – from the EU market rather than to encourage a gradual ‘cleaning up’ of supply chains. Inevitably, this carries a higher risk of companies abandoning suppliers in the countries of origin who cannot meet the criteria. This risk could be reduced by allowing for an initial implementation period.

Both types of due diligence obligation have value but will clearly be applied and enforced in different ways. This is discussed in Section 4.



3

Lessons from existing legislation

This section reviews existing legislation, in the EU and elsewhere, that either implements one of the due diligence approaches described in Section 2, or is in another way directly relevant. It focuses specifically on the EU Timber Regulation and the French Devoir de Vigilance law, which embody these two different approaches.

Specific relevant aspects of other pieces of legislation are also analysed.

3.1 EU Timber Regulation

Summary of key points:

- ▶ The main impact of the EUTR to date lies in the adoption of due diligence systems by timber operators.
- ▶ The legality criteria on which the obligation is based are not equally enforceable: rights to timber harvest has been the most commonly enforced criterion, land tenure rights and biodiversity conservation the least.
- ▶ The prohibition element (see below) has not been used in a prosecution for imported timber, although in some Member States it has been used to sanction domestic illegal logging. It is difficult to prove the illegal origin of imported products to the standards required for a conviction, and also to show that the company placing the products on the market knew that they were illegal.
- ▶ Substantial variation between Member States in levels of enforcement weakens the impact, and the restriction of the due diligence and prohibition obligations to 'first placer' companies magnifies the problems this causes. There have been many examples of imports of high-risk material shifting from Member States that have enforced the EUTR effectively to those that have not.
- ▶ The interpretation of 'due diligence' also varies between Member States; it is best enforced when requirements are clearly defined and where specialist courts deal with cases (as in the Netherlands).
- ▶ Levels of penalties also vary between Member States, but in general are too low
- ▶ Resources dedicated to enforcement vary substantially between Member States, but are in many cases too low.
- ▶ Cooperation between competent authorities within the EU and with equivalent authorities outside has been generally good, although sharing data with customs has been an issue in some Member States.

The EU Timber Regulation ((EU)995/2010) (EUTR) was agreed in 2010 and entered fully into operation in 2013.¹⁰ Designed to exclude illegally sourced timber from the EU market, it has three main obligations :

- It prohibits the placing on the EU market for the first time of illegally harvested timber, and products derived from such timber, whether imported or domestically produced. This is the prohibition element of the legislation.
- It requires operators who place timber products on the EU market for the first time to exercise due diligence with regard to those products, and to that end to possess a framework of procedures and measures: a due diligence system.
- It requires operators selling timber products after they have been first placed on the market ('traders') to keep records of their suppliers and customers.

¹⁰ See http://ec.europa.eu/environment/forests/timber_regulation.html.

Due diligence systems must provide means of ensuring access to information on the products and a process of analysing and mitigating against the risk of placing illegally harvested products on the market. This includes obtaining full information on the products, including their legal status and the countries, regions and sometimes forests of origin. The higher the risk of illegal behaviour in the place of origin, the greater the degree of knowledge the operator must have of the product and its chain of custody.

The presence of a document verifying legality – such as a document issued by a timber certification scheme – can be helpful, but is not conclusive, so reliance on certification by itself will not satisfy the regulation. This procedure is different from other EU legislation such as the Renewable Energy Directive, under which certification schemes can be recognised as fulfilling sustainability criteria for bioenergy feedstock. The decision not to allow certification schemes to provide proof of legality under the law was taken mainly to avoid outsourcing the responsibility for compliance to an external body, i.e. the certification scheme, which would potentially create a ‘liability loophole’ where the failure of an approved certification scheme, for example through fraud, would not result in any liability on the part of the company relying on it.¹¹

There is no minimum company size for the application of the EUTR: all timber operators first placing timber products on the EU market are covered, however small. Member States nominate ‘competent authorities’ to check compliance by operators, and to receive ‘substantiated concerns’ from third parties such as NGOs, where illegal behaviour or non-compliance is suspected.

The EUTR does not apply to all categories of timber products; wooden seats and printed papers, for example, are excluded. In 2018 the European Commission conducted a consultation on extending its coverage, but has yet to report any conclusions.

The due diligence obligation¹²

The main impact of the EUTR has been the adoption of due diligence systems by timber operators. These have been developed by the companies themselves; although the regulation allows the use of due diligence systems developed by ‘monitoring organisations’, and the Commission has recognised several of these bodies. In practice, take-up of these monitoring has been extremely low.

‘Illegal’ timber – the criteria against which due diligence is exercised – is defined in relation to the laws and regulations of the country of harvest; this includes legislation covering the right to harvest timber; payments for harvest rights and timber harvest-

¹¹ See also Strengthening Corporate Responsibility: *The case for mandatory due diligence legislation in the EU to protect people and the planet* (ClientEarth and Global Witness, July 2019).

¹² Most of the weaknesses with the EUTR identified here are discussed in Jade Saunders, *Ten Steps towards Enforceable Due Diligence Regulations that Protect Forests* (Forest Trends, 2020).

ting; environmental and forest legislation, including forest management and biodiversity conservation; third parties' legal rights to land use and tenure; and relevant trade and customs legislation. What companies are exactly supposed to do to ensure these criteria are met, however, is not spelt out; in practice, most companies have accumulated large volumes of documents from their suppliers in the countries of origin to attempt to demonstrate that the criteria have been met. In practice, competent authorities find that much of this documentation is not relevant. In addition, there is no reconciliation of documents between companies, so that one document demonstrating legal production could be reused several times by an unscrupulous supplier to launder illegal products.

Competent authorities have taken action against non-complying companies because of their failures to exercise due diligence for particular shipments or consignments, though weaknesses in a company's due diligence system (its risk assessment procedures, management systems, oversight, availability of training, etc) can also then be taken into account. Legislation relating to legal harvest has been the most common criterion against which enforcement action has been taken: 88 per cent of competent authority respondents to a recent survey by Forest Trends cited this criterion (see Table 1). Other forms of legality were less commonly cited; the lowest were third-party legal rights concerning land tenure and biodiversity conservation, at only 12.5 per cent.

Table 1 : Survey responses from EU enforcement officials showing their most enforced areas of legality under the EUTR¹³

ANSWER CHOICES	RESPONSES
Rights to harvest timber	87,50 %
Legal gazettment of boundaries to the area in which the harvest took place	37,50 %
Payments for harvest rights	25,00 %
Duties related to timber harvesting	37,50 %
Environmental legislation	62,50 %
Requirements for a forest management plan	50,00 %
Biodiversity conservation where directly related to harvesting	12,50 %
Third parties legal rights concerning use of forest resources that are affected by timber harvesting	25,00 %
Third parties legal rights concerning land tenure that are affected by timber harvesting	12,50 %
Requirements of export, insofar as the timber sector is concerned	37,50 %

¹³Source: *ibid.*

When asked why some elements of law had been less actionable under the EUTR, 54 per cent of competent authorities respondents selected 'companies I check do not know the exact legal requirements that fall under these categories of legislation in their source countries / supply chain; 46 per cent cited the absence of data to demonstrate compliance with the legal requirements that fall under these categories of legislation in their source countries or supply chains; and a further 26 per cent indicated that they had not been able to demonstrate a clear relationship between the single product line which officials had the power to check and compliance with all applicable legislation.¹⁴

In general, cooperation with producer country enforcement authorities is weak or non-existent, which makes obtaining evidence of failures of due diligence difficult. Scientific analysis of products, for example through isotopic or DNA testing, has been increasingly used by competent authorities to validate the information provided by companies on their products, since this provides evidence which does not rely on cooperation with any agency in the countries of origin.

This is a matter of particular concern with regard to land rights in countries where production is often associated with conflicts over land tenure; this is just as critically important for agricultural commodities as for timber, and probably more. A 2014 analysis of almost 73,000 concessions in eight tropical forested countries found that more than 93 per cent of the developments involved land inhabited by Indigenous Peoples or local communities. These concessions almost always generate conflict.¹⁵ Similarly, among 39 large-scale agribusiness investments analysed by the World Bank and United Nations Conference on Trade and Development (UNCTAD), land tenure was identified as the most common cause of grievances for affected communities and in 2013 half of all issues raised in letters of complaints received by the International Finance Corporation (IFC) and the Multilateral Investment Guarantee Agency (MIGA) related to land.¹⁶ In 2019 at least 212 environmental campaigners and land defenders, 40 per cent of them from Indigenous communities, were killed as they sought to protect their territories from incursions by mining interests, agribusiness, timber companies, and oil and gas corporations, according to Global Witness – the highest number of such killings on record for a single year.¹⁷

The prohibition

To date, the prohibition element of the EUTR has not been used in a prosecution for timber imported from outside the EU, though it has occasionally been used for

¹⁴ Source: *ibid.* Respondents were allowed to choose multiple responses.

¹⁵ *The Munden Project*, 2014. [Communities as Counterparties: Preliminary Review of Concessions Conflicts in Emerging and Frontier Market Concessions](#).

¹⁶ OECD *Guidance for Responsible Agricultural Supply Chains*.

¹⁷ It is sometimes argued that respect for customary tenure is not covered by the EUTR when customary rights are not legally recognised in national law. This is not correct. Legislation concerning third parties' legal rights to land use and tenure is spelt out in the EUTR as a criterion against which due diligence must be exercised. Legal rights include national law and international law ratified or adopted by the country. Almost all countries have ratified the Universal Declaration on Human Rights which requires all states to respect the right to property, and almost all countries have ratified the two UN Covenants (together with the Declaration The Bill of Rights) which supplement this. Legally speaking, this means that customary tenure rights protected by the Bill, and therefore protected by applicable law and hence by the nation states as they all have ratified these Covenants. Furthermore, many countries have protected customary law in the constitution.

domestically sourced illegal timber. For products imported into the EU it has proven to be difficult to prove that the origin is illegal to the standards required for a conviction and also to show that the company placing the products on the market knew, beyond reasonable doubt, that they were illegal. This would usually require corroborative detailed information from the country of harvest which, as above, is exceptionally difficult to obtain in a robust form. (In one notable case, when the documents provided by the company were clearly fraudulent, the authorities in the country of origin simply offered to provide different ones.) Reluctance on the part of the courts to judge the application of other countries' legislation may also be a factor. The prohibition element may therefore act more as a signal of intent to the market – which may be useful in itself – than as a practical enforcement tool, though opinions are divided.

Restriction of obligations to first placers

The fact that both the due diligence obligation and the prohibition apply only to operators – i.e. companies first placing products on the market – is a big weakness. In some cases, shell companies with no assets have been established to act as first placers; if they are found to be in breach of the law, they can be closed down with no loss to the real controlling interest.

Weaknesses in enforcement

Most of the weaknesses in the enforcement of the EUTR come about because of substantial variation between Member States in levels of enforcement. The restriction of the due diligence and prohibition obligations to 'first placer' companies magnifies the problems since, if the controls applied to first placers can be avoided in one Member State, the products will then be free to circulate within the EU without hindrance. As a result, there continue to be many examples of imports of high-risk material shifting from Member States that have enforced the EUTR effectively to those that have not.

The variation in levels of enforcement among Member States has arisen in two ways. First, while overall efforts – competent authorities' checks on operators – have increased over time, some competent authorities have dedicated fewer resources than others.¹⁸ Second, penalties for non-compliance vary significantly between Member States. The application of the EUTR in terms of penalties is a matter of Member State competence, and they can be applied quite differently. In the Netherlands, for example, failure to have a proper due diligence system in place can itself be a criminal act, whereas in Germany proof of illegality is needed before a breach of the EUTR is a criminal act – a much higher bar, helping to explain why there has been only one

¹⁸ For more detail, see WWF *Enforcement Review of the EU Timber Regulation (EUTR) : EU Synthesis Report* (WWF European Policy Office, 2019).

enforcement case in Germany in seven years. On top of this, some Member States have much lower penalties for non-compliance than others in terms of levels of fines or other powers, such as injunctions on sales.

In addition, courts frequently do not fully appreciate the problems the EUTR is designed to tackle or how the legislation is supposed to operate (this can be a general problem with all kinds of environmental crime), and as a consequence their interpretations of due diligence obligations can vary significantly across Member States. To choose one example, in Germany the competent authority ruled that a company should pay a €10,000 fine for lacking the required paperwork and any risk mitigation process; it had also already been warned. The company challenged this in court, however, and the judge struck down the fine on the grounds that the law was too complicated for the company (and him) to understand; and, furthermore, because the relevant documents were in French, which the company could not be expected to read.

It has also been argued that EU Member States which possess a civil law (or Roman law) system (which are almost all of them) find the concept of due diligence more difficult to enforce. Civil law systems rely on written statutes and other legal codes that are constantly updated and which establish legal procedures, punishments and what can and cannot be brought before a court. Compared to common law systems (as in the United Kingdom (UK) and United States (US)), where judges have greater freedom to interpret the law, in civil law systems a judge merely establishes the facts of a case and applies remedies found in the codified law.

Others disagree. Some Member States with a civil law system have succeeded in enforcing the EUTR with a reasonable degree of effectiveness. This is particularly true in the Netherlands, where EUTR cases are heard by specialist courts dealing with fraud and environmental crime – suggesting it is not so much the lack of specificity in the law describing what a company must do that is the problem, but the courts' understanding of it. And while the UK, with its common law system, also has a good record of enforcing the EUTR, courts and enforcement agencies can sometimes struggle to define what exactly companies are supposed to do.

An additional problem is caused in some Member States by the fact that customs agencies are not allowed by law to share relevant data. (Until recently this was a problem in the UK, but a recent reinterpretation of the law seems to have resolved it.) In addition to these problems caused by variations between Member States, in general levels of penalties – mainly monetary fines – are too low to have a significant dissuasive effect. The survey by Forest Trends showed that nearly 80 per cent of competent authorities believed that their penalty regime was too low.¹⁹ Injunctions

¹⁹ Jade Saunders, *Ten Steps towards Enforceable Due Diligence Regulations that Protect Forests* (Forest Trends, 2020).

on the sale of products until the company improves its due diligence system are more effective and are used in some Member States. Some Member States possess powers to confiscate products, which is an even more effective penalty, but does leave the competent authority with the – potentially significant – problem of disposing of the consignment.

On a more positive note, competent authorities have steadily improved their collaboration, with each other, with the Commission, and with enforcement agencies outside the EU facing similar challenges. The Commission's Expert Group on the EUTR meets four to five times per year to exchange information on shortcomings detected through checks of monitoring organisations and operators, and on the types of penalties imposed.²⁰ Since 2012, Forest Trends has hosted the Timber Regulation Enforcement Exchange (TREE) network, which meets regularly and includes, alongside EU competent authorities, representatives from enforcement authorities in the US, Canada, Australia and an increasing number of timber-importing countries in Asia.²¹

Impacts on the ground

While Member State competent authorities report on their activities in conducting checks on timber operators, there has been no systematic study to date analysing exactly how companies are responding to the EUTR in terms of actions on the ground in producer countries.²² Interviews and discussions with enforcement officials and companies suggest a number of preliminary conclusions about its impacts. It has:²³

- Significantly increased documentation of company supply chains.
- Encouraged companies to invest in long-term contracts and focus on responsible suppliers – to cite one example, moving from ad hoc small shipments from 40 or so suppliers to larger, longer-term contracts with 3–5 suppliers.
- Helped increase imports of certified timber products, particularly of complex products with multiple component parts, such as furniture; and partly as a result, increased investment in fraud-resistant systems by the Forest Stewardship Council, one of the two main global timber certification systems.
- Depressed prices on the market for timber from high-risk areas without full supply chain documentation.
- Reduced (to some extent) imports of illegally harvested timber to the EU market.
- Increased companies' engagement with governments in supplier countries; for example, many EU buyers will now only import wood from Peru if it has been audited and cleared by OSINFOR, the independent government oversight body.

²⁰ For a broader discussion of enforcement cooperation, see Jonathan Zeitlin and Christine Overdevest, 'Experimentalist interactions: Joining up the transnational timber legality regime', *Regulation and Governance*, 2020 ; <https://onlinelibrary.wiley.com/doi/pdfdirect/10.1111/rego.12350?download=true>

²¹ See <https://www.forest-trends.org/who-we-are/initiatives/>.

²² Forest Trends is about to conduct a survey and a series of interviews of companies across several European countries (though this has been delayed due to the coronavirus pandemic); in addition, consultants are currently conducting a 'fitness check' of the EUTR for the European Commission, which will involve an analysis of its impacts.

²³ Based on information from Forest Trends' TREE (Timber Regulation Enforcement Exchange) network; a presentation given by Jade Saunders (Forest Trends) at the workshop on 'What does an enforceable EU regulation tackling deforestation and human rights look like? Lessons from EUTR and Loi de Vigilance implementation' (Environmental Investigation Agency, Fern and Forest Trends, London, 21 January 2020); and interviews conducted for a study on 'Illegal trade in wildlife, timber and fish: Options for the UK post-Brexit' for the UK Department for International Development (DFID) (Duncan Brack, Forest Trends, December 2019).

– Increased innovation in supply chain scrutiny, for example in the use of isotopic analysis to support supply chain documentation; the development of online document management systems to link up suppliers and buyers without duplicating the paperwork load for each party; and greater use of remote sensing, drones and other measures to map supply chains and identify risks of illegal logging and deforestation.

3.2 EU Conflict Minerals Regulation

Summary of key points:

The Conflict Minerals Regulation (not yet in force) differs from the EUTR in important ways, including:

- ▶ Drawing its due diligence system explicitly from OECD Guidance, requiring third-party auditing of a company's due diligence system, and requiring companies regularly to report on their systems.
- ▶ The publication of guidelines to help enterprises identify high-risk areas, a list of conflict-affected and high-risk areas, and a 'white list' of global smelters and refiners which source responsibly.

The EU Conflict Mineral Regulation ((EU)2017/821) is relevant here because its drafters learned from the experience of the EUTR. Passed in 2017, it will enter fully into force in 2021.²⁴ It aims to target the trade in gold, tin, tantalum and tungsten from areas affected by or at high risk of conflict. Any enterprise importing these minerals to the EU, whether as ores, concentrates or processed metals, will be required to exercise due diligence in their supply chains, with the aim of ensuring that the minerals and metals they buy and sell are not funding armed groups or security forces in areas of conflict. The specific guidance for the process of due diligence is drawn from the OECD's *Due Diligence Guidance for Responsible Supply Chains from Conflict-Affected and High-Risk Areas*, originally agreed in 2011 and revised to cover these minerals in 2013.²⁵ In August 2018 the European Commission published non-binding guidelines to help enterprises identify high-risk areas, and stated that it intended to task a group of external experts to provide a (non-exhaustive) list of conflict-affected and high-risk areas, which would be regularly updated.

Although the regulation applies only to companies importing into the EU, it will have an indirect effect on companies outside, since EU importers will be required to identify the smelters and refiners in their supply chains and check whether they have the correct due diligence practices in place. If they do not, importers will need to manage and report on this. To help importers, the European Commission will create a 'white list' of global smelters and refiners which source responsibly. Potential risks of such a white list, however, are that it only captures a specific moment in time; and it could be used as an excuse by companies to avoid conducting active due diligence themselves.

²⁴ See <http://ec.europa.eu/trade/policy/in-focus/conflict-minerals-regulation/>

²⁵ Available at https://www.oecd-ilibrary.org/governance/oecd-due-diligence-guidance-for-responsible-supply-chains-of-minerals-from-conflict-affected-and-high-risk-areas_9789264185050-en

The procedure for importers is similar to that set out in the EUTR, requiring the companies to establish strong management systems, identify and assess risks in the supply chain and design and implement a strategy to mitigate the risks. It is different from the EUTR in also requiring an independent third-party audit of the due diligence system and an annual report from each company. ClientEarth and Global Witness have made the point that the role and recognition of these auditors should be contingent on these entities demonstrating they have sufficient expertise and capacity and do not have any conflict of interest.²⁶ The regulation will not apply to companies below a set threshold of volume of imports, specified in the regulation and different for each mineral and metal – the aim is to place requirements on roughly the top 80 per cent of imports. Downstream companies processing the metals into finished products have no obligations under the regulation, but are encouraged to use reporting and other tools to make their due diligence supply chain more transparent. Unlike the EUTR, there is no prohibition on placing any of the minerals sourced from conflict areas on the EU market.

3.3 French Devoir de Vigilance law

Summary of key points:

- ▶ Unlike the EUTR and the Conflict Minerals Regulation, the Devoir de Vigilance law is not specific to any supply chain.
- ▶ Vagueness in the legal text has created uncertainty: what exactly is meant by companies' due diligence obligations, and their liability if human rights abuses or environmental harm arise from their operations and supply chains, is not clearly defined.
- ▶ The state plays no role in compliance; the civil liability route must be pursued by third parties such as NGOs. The experience of enforcement through the courts so far is not encouraging.

In February 2017 France adopted the corporate *Devoir de vigilance des sociétés mères et des entreprises donneuses d'ordre* (Due diligence of corporations and main contractors) law applying to companies incorporated under French law with more than 5,000 employees in France or 10,000 world-wide.²⁷ Companies subject to the legislation (an estimated 150–250, though the government does not provide a list) must exercise due diligence in seeking to identify and avoid human rights violations, breaches of fundamental freedoms, violations of health and safety rights and environmental damage. Building on the UN Guiding Principles on Business and Human Rights, this includes the identification of risks, procedures for regular assessments of subsidiaries, sub-contractors and suppliers, actions to mitigate risks or prevent serious harm, and mechanisms for alerts and monitoring. The companies must implement a diligence plan setting out these risks and procedures and publish annual reports on progress.

²⁶ Strengthening Corporate Responsibility: The case for mandatory due diligence legislation in the EU to protect people and the planet (ClientEarth and Global Witness, July 2019).

²⁷ <http://www.csrandthelaw.com/2017/02/28/french-national-assembly-adopts-corporate-duty-of-vigilance-law/>

In March 2017 the proposed penalties for failing to prepare such a plan – fines of up to €10 million, or €30 million if the failure to develop a plan led to injuries that could otherwise have been prevented – were struck down as unconstitutional.²⁸ The general due diligence obligation and the requirement to implement a diligence plan remain, however, as do civil liability mechanisms in case of failure to implement the plan or if there are weaknesses in it. The state plays no role in compliance; the civil liability route must be pursued by third parties such as NGOs.

Since the law is still relatively new, companies' implementation of it is still evolving. In general, the treatment of risks has gained visibility within companies and disclosure has improved. In many companies greater dialogue is taking place with stakeholders, and knowledge has been increasingly transferred internally and externally, helping colleagues to stop working in silos and learn from each other. All firms have had to spend more time and effort on reporting. Often, firms have created new organisations and methodologies to respond to the new challenges. The process has also encouraged the development of a new sector of service delivery in risk assessment and compliance.²⁹

The law does not specify the level of detail expected in companies' vigilance plans, but requires them to prioritise their treatment of risks. Surveys and analyses of the initial sets of reports issued by companies suggest that while the majority of those affected have made commitments to due diligence, they have not provided much detail how they have identified and addressed human rights risks.³⁰ Risks were often assessed only in regard to the company rather than to the environment or human rights, and without regard to specific high-risk countries or regions; many appeared to be one-off analyses with no information available about how they would be reviewed or updated. Risk mitigation strategies were not always included, and risks relating to sub-contractors were often omitted entirely. In general, however, the level of detail appears to be growing over time.

Vagueness in the legal text has created some uncertainty: what exactly is meant by companies' due diligence obligations, and their liability if human rights abuses or environmental harm arise from their operations and supply chains, is not clearly defined. Olivier de Schutter, the UN Special Rapporteur on extreme poverty and human rights, has argued that there is a risk that companies may avoid liability simply by adopting the due diligence plan even while failing to take any action to implement it properly.³¹ Debates have revolved around the interpretation of the law and certain key words like 'reasonableness' or 'prioritisation', together with the meanings of terms such as 'environmental harm'. It is not clear whether these will only be clari-

²⁸ <https://www.jdsupra.com/legalnews/french-companies-must-show-duty-of-care-56981/>.

²⁹ Anne Duthilleul and Matthias de Jouvenel, *Evaluation de la mise en œuvre de la loi n° 2017-399 du 27 mars 2017 relative au devoir de vigilance des sociétés mères et des entreprises donneuses d'ordre* (Conseil Général de l'Économie, January 2020)

³⁰ See *Strategies for Responsible Business Conduct* (PwC for Netherlands Ministry of Foreign Affairs, December 2018); *Loi sur le devoir de vigilance des sociétés mères et entreprises donneuses d'ordre – Année 1: Les entreprises doivent mieux faire* (Sherpa, February 2019).

³¹ Olivier de Schutter, 'The requirement to practice due diligence – a floor not a shield' (BHR Symposium, 10 September 2020); <http://opiniojuris.org/2020/09/10/bhr-symposium-the-requirement-to-practice-due-diligence-a-floor-not-a-shield/>.

fied if and when court cases take place, or whether the government may decide to issue more specific guidance. To date, six formal notices have been served and two of them have led to court cases. In the only one to have been considered by a court to date, however, the judges decided that their court was not the right venue to hear such a complaint and concluded that it should be heard in a commercial court, which normally deals with disputes between companies.³² As the NGOs who took the case observed, this implies that companies could only be judged after any damage had occurred, rather than on the basis of preventing future violations, clearly contrary to the intention of the Devoir de Vigilance law.

3.4 EU Illegal, Unreported and Unregulated (IUU) fishing Regulation

Summary of key points:

- ▶ The IUU Regulation's 'carding' or early warning system may be adaptable to countries or sub-national jurisdictions producing forest risk commodities.
- ▶ Banning imports from sub-national jurisdictions would require (a) the country of origin to agree to the system; and (b) an effective traceability system to be in place to allow exporters to segregate supplies from high-risk areas.

The EU Regulation to Prevent, Deter and Eliminate Illegal, Unreported and Unregulated (IUU) fishing ((EC)1005/2008) entered into force in 2010 with the aim of excluding IUU fish from the EU market.³³ It establishes a catch certification scheme under which only marine fishery products validated as legal by the competent flag state can be imported to or exported from the EU (similar in outline to the Forest Law Enforcement, Governance and Trade (FLEGT) licensing system for timber imports) and also allows for substantial penalties to be applied to EU nationals who engage in or support IUU fishing anywhere in the world.

It does not incorporate a due diligence approach, but DG Environment appears to be interested in adapting, for the agricultural sector, the 'carding' system used by the IUU Regulation it employs, to rate countries exporting fish to the EU. Under the IUU Regulation, third countries are required to notify the Commission that they have the necessary instruments, procedures and administrative structures for the certification of catches by vessels flying their flag. The Commission enters into dialogue with countries it believes are not combating IUU fishing effectively. Countries may be issued a 'yellow card' (officially warned) and if reforms are not carried out, or not carried out quickly enough, a 'red card', resulting in a ban on imports to the EU of fish products caught by vessels flying the flag of the red-carded country. Both yellow and red cards can be lifted when there is clear evidence that the situation has been rectified.

³² Ed Reed, 'Win for Total in French case over duty of vigilance', Energy Voice 31 January 2020.

³³ See summary and links at https://ec.europa.eu/fisheries/cfp/illegal_fishing_en; *The EU IUU Regulation – Building on Success: EU progress in the global fight against illegal fishing* (Environmental Justice Foundation, Oceana, Pew Charitable Trusts and WWF, February 2016).

The system seems to work effectively, but applying it to forest risk commodities would involve some challenges. Whereas many countries export fish to the EU, and therefore banning imports from one country, or a small number, has only a limited impact on the EU market, most forest risk commodity exports come from a much smaller number of countries, and banning imports would therefore have a far greater impact. It may be possible to adapt the carding system to identify high-risk areas, either countries or sub-national jurisdictions. Banning imports from sub-national jurisdictions would require (a) the country of origin to agree to the system; and (b) an effective traceability system to be in place to allow exporters to segregate supplies from high-risk areas. Alternatively, the Commission could use the carding system to flag up the need for enhanced due diligence for companies sourcing from those areas, or publish guidelines to help enterprises themselves identify high-risk areas, as in the Conflict Minerals Regulation.

3.5 US Lacey Act

Summary of key points:

- ▶ Penalties under the Lacey Act depend partly on the efforts the company has made to avoid sourcing illegal products; this has some parallels with the due diligence approach.
- ▶ For imports of timber, companies are required to file a declaration including the scientific name, value, quantity, and country of harvest of the timber; this has proved helpful in enforcement since it does not always require corroborative information from the country of origin.

In 2008, the US Congress voted to amend the Lacey Act, a law dating originally from 1900 that made it illegal to import or handle fish and wildlife produced illegally in foreign countries. The amendment extended this to plants, with the main aim of targeting illegal timber.

The amended Act makes it unlawful to 'import, export, transport, sell, receive, acquire or purchase in interstate or foreign commerce ... any plant taken, possessed, transported or sold ... in violation of any foreign law'.³⁴ The penalties rest on the level of intent that can be shown on the part of the violator. When no intent to break the law can be shown, penalties rest on the extent to which the individual should have known 'in the exercise of due care' that the products had been illegally produced. Penalties can include fines and imprisonment, and in all cases the illegal products can also be forfeited.

The Lacey Act also requires importers of timber and wood products to file a declaration including the scientific name, value, quantity, and country of harvest of the

³⁴ Lacey Act, section 3372 (a)(B)(2)(i)

timber. To date, this declaration requirement does not apply to all timber products; it has not yet been phased in for composite products, due to the complexity of the supply chains, challenges in identifying and tracing wood and the alteration of material from the production process. Falsifying the declaration or labels or markings of the products is an offence.

By the end of 2019, just five cases of illegal timber imports had been prosecuted. Three of the five related to illegal imports from Peru – one based on a tip-off from a business owner, another from an affirmative admission of violations by a company, and the third from information provided by the Peruvian government. The other two cases were initiated after investigations by the Environmental Investigation Agency. Two of the cases, involving the companies Gibson Guitar and Lumber Liquidators, led to the implementation of a compliance programme as part of the penalties, including the adoption of a ‘due care standard’ to ensure legal wood sourcing and an unbroken chain of custody for all imports, and external auditing of the company’s compliance with its agreed programme and the Lacey Act.

In some ways this ‘due care’ requirement is similar to due diligence, and the latter case in particular appears to have had impacts in China, where suppliers are now increasingly aware that illegal wood products are no longer accepted in the US. Whether they have had an impact on other US importers is less clear; both of the companies involved were very obviously ‘bad actors’ (which is largely why they were prosecuted – the US authorities, like most public prosecutors, tend to prioritise the cases which will be easiest to win and result in the largest penalties), so whether the vast majority of timber importers, who do not behave in this way, have altered their sourcing arrangements is unknown.

In general for Lacey Act cases, the most common prosecutions are for trafficking violations (importing, exporting, transporting, etc etc), for which forfeiture is generally the minimum penalty, with fines and jail time in a smaller number of cases. Forfeiture is more common, as under the Act’s strict liability provisions the government does not need to prove any particular level of knowledge on the part of the person that trades in plants, wildlife, or fish contrary to the Act; the products can be forfeited regardless. Three of the five timber cases have involved declaration violations, as described above.

3.6 Conclusions about due diligence legislation for forest risk commodities

Summary of key points:

- ▶ To be effective, any due diligence legislation needs to be clear about what the government requires of companies. If the requirements are not clearly defined, enforcement will be difficult.
- ▶ Risk assessments of countries or sub-national jurisdictions conducted by the Commission or other external bodies are likely to be helpful to enterprises sourcing from high-risk areas.
- ▶ Obtaining reliable evidence of breaches of due diligence, or proof that the products meet the criteria against which due diligence is exercised, from the countries of origin is always likely to be difficult. The greater the extent to which enforcement agencies can use evidence that is available in their own countries – e.g. through isotopic testing or satellite data – the more effective enforcement will be. This implies that the legislation may need to include a requirement for companies to declare specified information about their products at the point of import or placing on the market.
- ▶ Another category of evidence which can be monitored without needing evidence from countries of origin is the company's due diligence system itself. Setting clear standards for the system, and checking the adequacy of companies' due diligence systems is important; third-party auditing may help as long as it is free of conflicts of interest.
- ▶ The substantial variation in enforcement efforts between Member States seen in the EUTR is a key weakness which needs to be addressed.
- ▶ Fines for non-compliance need to be larger and possibly linked to the size of the business; injunctions on sales should also be considered.
- ▶ The due diligence obligation must not be restricted to first placers, but should extend throughout the supply chain.
- ▶ Certification schemes may have a role to play to mitigate risks but are not by themselves adequate to prove the exercise of due diligence and should not be treated as proof of compliance by the legislation.
- ▶ Good collaboration between competent authorities within the EU and with countries outside is essential.
- ▶ Data-sharing from customs agencies should be mandatory and included in the legislation.
- ▶ The 'substantiated concerns' route for local and international NGOs and other bodies to raise concerns directly with EUTR competent authorities is useful and should be included.

Based on these analyses, conclusions can be drawn about how both types of due diligence legislation can be most effectively enforced with reference to new due diligence legislation on forest risk commodities.³⁵

First, as revealed by the experience of the EUTR and Devoir de Vigilance law, a due diligence obligation can be difficult to enforce, particularly in some jurisdictions, if its requirements are not clearly defined. To be effective, any due diligence legislation needs to be clear on what the government requires of companies, and it needs strong procedures for monitoring how these companies meet these expectations. Scope, criteria, definitions, transparency requirements, independent monitoring, reporting and access to justice should be carefully thought through. The vaguer the legislation, the less likely it is to be effectively enforced.

Risk assessments of countries or sub-national jurisdictions conducted by the Commission or other external bodies are likely to be helpful to enterprises sourcing from high-risk areas. The carding system of the EU IUU Regulation, the list being drawn up under the Conflict Minerals Regulation, the US Department of Labor's list of goods and source countries at risk of child labour or forced labour are all examples of this kind of approach. A 'white list' of companies at particular key points in the supply chain – like the list of responsible smelters and refiners being drawn up for the EU Conflict Minerals Regulation – could also be helpful, but may be impractical given the numbers of companies in most forest risk commodity supply chains. And as noted above, the potential risks of such a white list is that it only captures a specific moment in time; and it could be used as an excuse by companies to avoid executing active due diligence themselves.

Second, obtaining reliable evidence from the countries of origin of breaches of due diligence, or proof that the products meet the criteria against which due diligence is exercised is always likely to be difficult, particularly where enforcement agencies in producer countries are not willing to cooperate. For this reason, many international environmental agreements, and domestic legislation, that seek to exclude products from trade – e.g. illegal timber (FLEGT Voluntary Partnership Agreements (VPAs)), endangered species (CITES), IUU fish (EU IUU Fishing Regulation) or illegal ozone-depleting substances (Montreal Protocol) – rely on licensing systems. Enforcement agencies in the countries of import only need to check for the presence of the license rather than evidence of legitimate production in the country of origin. As long as the licenses are issued correctly (which can be a problem), this can be an effective way of achieving the objective.

In the absence of licensing, the greater the extent to which enforcement agencies can use evidence that is available in their own countries, the more effective enforce-

³⁵ Most of these points are included in Saunders, *Ten Steps towards Enforceable Due Diligence Regulations that Protect Forests*.

ment will be. For the EUTR, scientific evidence obtained through, e.g. isotopic or DNA testing, can help determine whether timber products are what the companies claim they are; whether this can also be applied to agricultural commodities will need to be determined, and it is likely that there will be geographical restrictions on what is possible. Other forms of evidence may also be available; e.g., the extent of deforestation in the source area, which can be monitored via satellite imaging.

The legislation would also be easier to enforce if it included a requirement for companies to declare specified information about their products at the point of import or placing on the market. This is implicit in the EUTR (the company must have access to information about the products, though it does not have to publish anything) and explicit in the Lacey Act import declaration. This declaration requirement could perhaps replace, or at least supplement, the provision of documentary evidence that is how companies currently mainly show their compliance with the EUTR.

Third, another category of evidence which can be monitored without needing evidence from countries of origin is the company's due diligence system itself. Checking the adequacy of companies' due diligence systems already plays a role in EUTR enforcement when an investigation is made into a specific consignment of suspect timber. A systematic review and analysis of companies' due diligence systems – potentially based on the criteria in the OECD/FAO Guidance for Agricultural Supply Chains – could play a role in enforcement, checking that a company's system ensures that it is able to identify, assess, mitigate, prevent and account for actual and potential adverse impacts of their activities as an integral part of its decision-making and risk management systems.

The requirement in the EU Conflict Minerals Regulation for companies to have their due diligence systems third-party audited provides another possible route to enforcement as long as there is no conflict of interests – i.e. the auditing body must not be involved in providing or developing the system. The legislation must, however, make clear that the simple possession of a due diligence system is not by itself sufficient; the company must also ensure that it is implemented, monitored and continually improved.

Fourth, a major problem with the EUTR is the substantial variation in enforcement efforts and penalties across the EU. Some form of harmonisation of implementation across the EU is required. The Commission has a responsibility to ensure that EU legislation is fully implemented across all Member States, and that all countries can pursue infractions proceedings in the case of a failure to implement, though this procedure can take years. Doing all that can be legally done to avoid this type of variation is important.

Fifth, on penalties, EU legislation typically includes phrases such as ‘effective, proportionate and dissuasive’, but existing EUTR penalties are clearly inadequate. Even in Member States which do implement the EUTR effectively, penalties are often restricted to fines, which can be easily absorbed in the cost of doing business. Increasing the maximum size of financial penalties and linking them to the size of the business, as well as extending penalties to injunctions on sales would have a greater impact and should be considered.

Sixth, one specific problem with the EUTR is the fact that its due diligence and prohibition obligations only apply to companies first placing timber products on the market. This undermines its overall effectiveness, as imports can be directed to Member States with weak enforcement – the system is only as good as its weakest link – and/or shell companies can be established to act as first placers. These problems would be lower if the due diligence obligation (and prohibition, if there is one) extend throughout the supply chain. This would, however, then create the additional problem of placing burdens on companies – particularly small and medium-sized enterprises (SMEs) – who are many steps removed from the negative impacts the legislation is designed to address and who accordingly have little ability to affect them.

Seventh, the cautious treatment of certification schemes in the EUTR – they may be useful but are not by themselves adequate to prove the exercise of due diligence – is the right approach and should be maintained.

Finally, there are other practical ways in which enforcement efforts can be supported:

- Collaboration between competent authorities within the EU and with countries outside is essential. The TREE Network and the Expert Group on the EUTR are good models to follow.
- The availability of import data from customs agencies is essential but not always easy. Data-sharing should be mandatory and included in the legislation.
- The ‘substantiated concerns’ route for local and international NGOs and other bodies to raise concerns directly with EUTR competent authorities is useful and should be included.



4

Design and enforcement

As noted in Section 1, we assume that two pieces of EU legislation will be introduced: a broad corporate (or 'horizontal') due diligence obligation for human rights and environmental harm, applying to companies' entire operations and supply chains; and a specific due diligence obligation relating to a defined list of forest risk commodities, including conditions on market access.

As discussed in Section 2, these two legislative approaches are based on different concepts of due diligence. The broad corporate due diligence legislation is likely to be based on the concept of due diligence that stems from the UN Guiding Principles and OECD Guidance: due diligence as a continuous process of improvement. The specific forest risk commodity legislation is likely to be based on the second concept, of a process that must be followed before the products can be placed on the market.

Since both of these pieces of legislation will affect companies placing forest risk commodities on the EU market, we consider each of them from the point of view of how they can best be designed and implemented to maximise the chances of effective enforcement. This section puts forward proposals for each legislative instrument and for some elements that are common to both.

This is a rapidly evolving debate, and it would benefit from much greater consideration and more evidence of the impacts, positive and negative, of existing legislation. The proposals included here should therefore not be treated as final and may need to be modified or further developed in the future.

4.1 Broad corporate due diligence legislation

Enforcing due diligence as a continuous process of improvement

The legislation should create an obligation on companies to exercise due diligence for human rights and environmental harm across their entire operations and supply chains.

As discussed in Section 2.1, the due diligence approach as formulated in the UN Guiding Principles and OECD guidance is understood to be an ongoing process, involving identifying and assessing the actual and potential risks of human rights abuses and environmental harm (and/or other specified impacts), acting upon the findings of this risk analysis, tracking the effectiveness of these actions, communicating how impacts are addressed, and providing remediation to those adversely affected.

It is not assumed that all negative impacts can be avoided immediately; companies are supposed to prioritise their actions depending on the level and type of risk, and work with suppliers to tackle the problems rather than disengage straight away.

There is an assumption that the standard of performance will improve over time. This gradual evolutionary approach rewards engagement, encouraging companies to work with their suppliers in producer countries to reduce over time the extent of human rights abuses and environmental harm in their operations.

Judging whether a company has exercised sufficient due diligence in any given case – either by changing its suppliers' behaviour or by changing its suppliers – is made more complicated, however, by the fact that the company may be able to argue that it has not yet had sufficient time to be able to achieve the desired outcome. While a reasonable approach for companies genuinely committed to improving their performance, this gradual evolutionary concept is clearly open to abuse in the sense that companies may claim they are making progress without doing so.

Is there a way in which legislation can require companies both to make progress and to show they are doing so? Possibly, but it is not simple. Whoever enforces the obligation (see below) would have to reach a judgement on whether the company has made sufficient progress in improving its performance, given the particular circumstances of the company, commodity and source country. This could be assisted by a process of setting a benchmark, or series of benchmarks, against which to judge progress towards a defined goal (which is presumably a negligible risk of the presence of human rights abuses and environmental harm in the commodity supply chain in question), and a target date, or dates, for the achievement of the goal.

This process could encourage most companies to improve their performance, as many have in France following the Devoir de Vigilance law. It could also deter flagrant abuses of human rights or environmental harm, but it may not do very much to improve the performance of companies who are doing something but not very much. We conclude, therefore, that additional means of enforcement will be necessary.

Enforcing the possession of a due diligence system

The legislation should create an obligation on companies to have in place a due diligence system to a specified standard, based on OECD Guidance and possibly audited by a third-party against the standard. Systems should be regularly monitored by a government enforcement agency.

For enforcement agencies to be able to do this will require:

- Detailed guidance on what constitutes an adequate due diligence system, potentially drawn from OECD guidance documents and possibly varied by commodity and/or country of origin.
- An obligation on the company to publish regular reports describing its due diligence system and its progress over time, with as many externally verifiable indicators as possible.
- Monitoring of the implementation of the system by a competent authority, and possibly an external audit of the company's due diligence system against the quality standard.

Liability and remediation

The legislation should establish liability for companies found to be in breach of their due diligence obligation and for companies found to be causing harm independent of the due diligence carried out.

The simple possession of a due diligence system must not provide companies with a guarantee of legal immunity from civil liability claims where harm has been caused by their failure to exercise due diligence – as the French law appears to risk (see Section 3.3). To avoid due diligence becoming a 'tick box' exercise, once a victim has proven that harm has been inflicted as a result of the company's actions or failures to act, it should be for the company to rebut the presumption that it could have done more to prevent such harm from materialising. As Olivier de Schutter has argued:

This is why human rights due diligence and potential liability for violations occurring in the supply chain should be treated as two separate, albeit complementary, duties. The former is a duty to prevent the risk of human rights violations occurring within

*the supply chain or the corporate group. It is forward-looking, essentially imposing on companies that they seek information from their business partners or affiliates and that they act on the basis of such information to minimise the negative human rights impacts of their activities. The latter is a duty to accept liability where such preventative measures have failed, but where it can be shown that, should the company have done more, it could have avoided the harm from occurring.*³⁶

A process to assess the remediation provided by companies admitting liability or found to be liable in a court case is also likely to be necessary. Agencies appointed by Member States may be the most appropriate to carry out this function, though this could be a complex procedure. The OECD Due Diligence Guidance for Responsible Business Conduct outlines procedures for remediation, though without providing much detail.

Grievance and complaints mechanisms

The legislation should include requirements on companies to establish grievance and complaints mechanisms.

A well designed and functioning grievance mechanism could go a long way to prevent harm being inflicted in the first place. An ‘early warning’ risk awareness system offering a locally based, simple and mutually beneficial way to settle issues between companies and communities would help to resolve minor disputes and also provide valuable feedback to companies and indicate possible systemic changes required to address particular grievances. The OECD/FAO Guidance for Responsible Agricultural Supply Chains details eight essential characteristics of an effective grievance mechanism; it must be: legitimate; accessible; predictable; equitable; transparent; rights compatible; a source of continuous learning and based on engagement and dialogue (the Guidance spells these out in more detail).

A complaints system will also be necessary in cases where the grievance mechanism fails. Some have argued that complaints and grievance mechanisms should be separate from each other so that third parties can bring complaints without having to go through the grievance mechanism first, e.g. in cases where companies are violating the law. Any complaints mechanism should allow third parties such as NGOs or local communities in producer countries to lodge complaints with an independent agency. The National Contact Points that governments are obliged to establish under the OECD Guidelines for Multinational Enterprises could provide a potential route, but there is a strong case for a pan-EU contact point, to avoid implementation weaknesses in individual Member States to undermine the system.

³⁶ de Schutter, *The requirement to practice due diligence – a floor not a shield*.

4.2 Specific forest risk commodity legislation

This piece of legislation will put into practice the concept of due diligence discussed in Section 2.2: a process that must be followed before forest risk commodities (which would be listed in the legislation) could be placed on the EU market.

To ensure that companies that follow the rules and place only products meeting the criteria on the market are not undercut by companies not following the rules, enforcement must be more immediate and effective than is possible under the gradual evolutionary approach encompassed in the broad corporate due diligence legislation discussed above. This has a number of implications.

Due diligence criteria

The due diligence obligation must be as simple and as easily verifiable as possible. Further discussion is needed on the detailed criteria against which the obligation is to be exercised, and their enforceability.

The criteria against which companies are required to exercise due diligence are important. As discussed in Section 3, they need to be specified in detail. Much of the argument for having commodity-specific legislation rests on the need to define the criteria in more detail than would be possible under a broader approach applying to companies' entire operations and supply chains.

In June 2020 the Environment Committee of the European Parliament published a draft report on legislation for due diligence for 'forest and ecosystem risk commodities'. It proposes that operators be permitted to place these products on the EU market only when they are able to demonstrate that there is a negligible risk that the products did not originate from land obtained via the conversion of natural forests or other natural ecosystems, did not originate from natural forests and natural ecosystems undergoing degradation, and are not produced in, or are linked to, violation of human rights.³⁷

In August 2020 the UK government published a proposal for consultation on a due diligence obligation for forest risk commodities.³⁸ Businesses above a certain threshold (to be determined) would be prohibited from using, 'either in production or trade within the UK, forest risk commodities that have not been produced in accordance with relevant laws in the country where they are grown' and would be obliged 'to conduct due diligence to ensure that forest risk commodities that have not been legally produced do not enter their supply chain, and to report on this exercise publicly'. 'Relevant laws' include those that protect natural forests and other natural ecosystems from being converted into agricultural land. The government explained

³⁷ Draft Report with recommendations to the Commission on an EU legal framework to halt and reverse EU-driven global deforestation (2020/2006 (INL)) (European Parliament Committee on the Environment, Public Health and Food Safety, 15 June 2020); available at https://www.delara-burkhardt.eu/wp-content/uploads/sites/872/2020/06/Burkhardt_Draft_Report_Deforestation_15_June_2020.pdf.

³⁸ See https://consult.defra.gov.uk/eu/due-diligence-on-forest-risk-commodities/supporting_documents/duediligence-consultationdocument.pdf

that it had opted for legality as a basis for the legislation rather than sustainability because of the additional complexity of sustainability criteria and also because of a concern not to be seen to be imposing external criteria on the countries of origin of the products. Many UK NGOs have argued that this proposal is too narrow, and that it should be based on sustainability or no-deforestation, and including human rights, rather than legality criteria.

A full discussion on the due diligence criteria for forest risk commodities goes beyond the remit of this paper, but it is directly relevant in terms of enforceability. While it should not be too difficult to draw up criteria on the basis of legality or sustainability including human rights – there are many existing frameworks to draw on, including certification scheme standards and the Accountability Framework Initiative – obtaining the evidence needed to prove a company's due diligence to a sufficient standard is much more difficult.

As noted in Section 3.1, it has proved difficult (though not impossible) to obtain evidence for many of the criteria underlying the EUTR other than legal rights to harvest, specifically when there is no or little cooperation with producer country governments.

We conclude, therefore, that further discussion is needed on the detailed criteria against which the obligation is to be exercised, and their enforceability. The wider the range of criteria the more difficult enforcement becomes.

In an ideal world, this legislation would be developed hand in hand with efforts to negotiate bilateral partnership agreements between the EU and producer countries so that only products meeting the criteria can be imported into the EU – in the same way as the FLEGT VPAs complement the EUTR. This would help to address the underlying causes of deforestation and human rights violations on the ground in producer countries, with, potentially, a much greater impact than due diligence legislation by itself.³⁹

Declaration requirement

The legislation should include a requirement for the company to file a report on every import stating that the commodities have been produced in accordance with a standard that can be independently verified.

We discussed in Section 3.1 the difficulties in enforcing the prohibition on placing illegally harvested timber on the market included in the EUTR, mainly because of the difficulties in enforcement caused by the requirement to obtain evidence from the countries of

³⁹ For more details, see forthcoming Fern's partnership paper

origin of the products. One way round these difficulties is to place the company under an obligation to file a declaration for each shipment or consignment of products it places on the market. Such a declaration would include information on the type and source of the product and the extent to which it meets specified standards. These standards would be independently verifiable through, for example, isotopic or DNA testing or satellite imaging of changes in forest cover after a set date included in the declaration.

Similar to the US Lacey Act declaration requirement – and the kind of information that operators should have access to under the EUTR – this adds the possibility of enforcement action against companies if incorrect or fraudulent information is included in the declaration. This is particularly true where the information can be relatively easily checked – for example, where satellite images reveal that the area the product is sourced from has been deforested later than the cut-off date although the company has claimed that it has not been.

Due diligence as a defence against liability

Consideration should be given to the advantages and disadvantages of the possibility of the legislation including the exercise of due diligence as a defence against liability.

The draft report for the European Parliament Environment Committee referred to above also proposes, separately from its market restriction, obligations to conduct due diligence, to consult relevant stakeholders, to report on their processes and to retain relevant documentation. How the due diligence obligation is linked to the market restriction is not clear, but the section on civil liability includes the proposal that companies will be:

... liable for harm arising out of human rights or environmental abuses directly linked to their products, services or operations through a business relationship, unless they can prove they acted with due care and took all reasonable measures given the circumstances that could have prevented the harm. Economic operators may therefore discharge their liability if they can prove that they took all due care to identify and avoid the damage.⁴⁰

Whether ‘due care’ is the same as the due diligence requirement set out earlier in the report is not explained, but this seems likely. Thus, a company’s exercise of due diligence could be used as a defence against legal claims of liability if harm occurs as a result of the company’s actions or failures to act. This is similar in some ways to the US Lacey Act, where the penalties are varied depending on the efforts the company has made to ensure that the products have been legally produced.

While this is an interesting idea, we believe it needs further consideration before

⁴⁰ Draft Report with recommendations to the Commission on an EU legal framework to halt and reverse EU-driven global deforestation, Section 5.2.

we can recommend it. There is a danger, as discussed above, that a limited exercise of due diligence could be used as an excuse for not making greater efforts, thereby providing a ‘get out of jail free’ card for companies causing harm.

4.3 Common elements

Some elements are common to both pieces in legislation and should be included in both.

Reporting obligation

The legislation should require a company to publish a report on its due diligence system and its activities in implementing it, to allow for effective monitoring.

Reports on companies’ due diligence systems are a key part of the due diligence approach; as the OECD guidance expresses it, companies should ‘Communicate externally relevant information on due diligence policies, processes, activities conducted to identify and address actual or potential adverse impacts, including the findings and outcomes of those activities’.⁴¹ Requirements to publish reports on due diligence systems and implementation are already incorporated into various forms of due diligence legislation, and reporting on a range of environmental and social issues is becoming more widespread, for example through the EU Non-Financial Reporting Directive (which is currently under review).

The inclusion of a reporting requirement in both pieces of due diligence legislation would be an important means of improving transparency and assisting compliance; where possible it should build on or replace systems already put in place for other reporting requirements rather than simply add more obligations on top.

Reporting is however only ever a tool, not an end in itself. To be an effective tool, it should not be seen as a static instrument but as a process of continuous improvement, e.g. by first calling attention to unsustainable production practices; then supporting supply chain actors in making more sustainable decisions; then ensuring that those same actors are held to account, and are not falling behind in delivering on their commitments; then providing updated information to inform renewed efforts to improve practices; and so on.

The aim of the reporting requirement should be to enable enforcement of the legislation and ensure continuous improvement. Hence the reporting requirement should be such that it provides the information to allow both monitoring organisations like competent authorities and the public at large to not only scrutinise if

⁴¹ OECD Due Diligence Guidance for Responsible Business Conduct, p. 33.

the companies act in compliance with the legislation but also how the company is progressing. Clearly, competent authorities will need sufficient resources to enable them to monitor and act on companies' reports.

Thresholds

The due diligence obligations should extend as far as possible throughout the supply chain.

As discussed in Section 3, many existing pieces of due diligence legislation apply only to companies above a certain threshold, by turnover or volume of imports or number of employees, or by their position in the supply chain.

This inevitably creates loopholes, and, as far as possible, we believe that the due diligence obligations should extend throughout the supply chain. However, the legislation should recognise that companies not sourcing directly from producer countries have limited capacity to affect conditions of production, so for the broad corporate due diligence legislation the obligations may need to be varied by size; linking the due diligence requirements to the size of the company or to the perceived risks are possible ways of dealing with this.

This does not apply to the forest risk commodity-specific legislation, where it is important to follow the movement of the products throughout the supply chain. The obligations should not, therefore, be limited only to companies first placing products on the market. Recognising, again, the limited ability of companies not sourcing directly from producer countries to affect conditions of production, a possible solution could be to adopt the system used in the Dutch Child Labour Due Diligence Law (not yet in force), which requires companies either to conduct due diligence themselves or to obtain a declaration from their suppliers stating that they have themselves conducted due diligence.

Enforcement agencies' capacities and powers

Both pieces of legislation should be monitored and enforced by government agencies with sufficient powers and resources.

The law would be enforced more effectively if the following conditions are in place:

- Systematic monitoring of companies' performance based on their reports, investigations and other sources of information.
- Resources sufficient to enable the agencies to monitor companies' due diligence

systems and import declarations and to take action against cases of potential non-compliance.

- Sufficient enforcement powers and penalties, including the possibility of administrative penalties and powers to issue injunctions against sales and confiscate products.
- Access to data, primarily from customs; this may need to be written into the legislation.
- Encouragement for collaboration with other Member States' authorities and with equivalent enforcement agencies outside the EU; existing frameworks such as the TREE network work well and should be extended.
- Creation of a pan-European contact point with an overview of all complaints raised and the ability to act on them.
- The ability to bring cases before specialist courts familiar with and trained in human rights and environmental cases involving the laws of other countries.
- A requirement to publish information on their activities, such as numbers of companies checked, etc.

We recognise that many of these matters are mainly issues of Member State competence.

Given how much information competent authorities will need to have access to, the more information that can be provided from producer countries the better – not only from government authorities but also from community, civil society and industry monitors, and whistle-blowers. A 'substantiated concerns' provision (as in the EUTR) will be essential. There is also a strong case for some kind of 'risk register' drawn up by the Commission, and/or guidance to companies in identifying high-risk areas and sources.

Any legislation is only as effective as its enforcement. This paper aims to draw out lessons learned from enforcing existing due diligence legislation and makes recommendations for EU-level due diligence legislation that will apply to forest risk commodities. We recognise that it is likely that the two broad approaches to due diligence – what we have called ‘due diligence as a continuous process of improvement’ and ‘due diligence as a market obligation’ – will be encompassed in two different legislative instruments, the first applying to all companies and not specific to any sector or commodity, and the second applying to forest risk commodities and companies that place them on the EU market. Section 4 puts forward our proposals for each type of legislation; below we summarise our main conclusions that apply to both.

First, to be enforceable the law should be very clear on what exactly companies’ requirements are under the law. Strong procedures must be in place for monitoring and enforcing companies’ implementation of these requirements. The vaguer the legislation, the less likely it is to be effectively enforced. Second, legislation should include mechanisms that allow competent authorities or other organisations in the EU to be able to gather proof of infringements. This would be easier if mechanisms which do not rely on collaboration with agencies in the countries of origin – such as import declarations – can be in place. Third, companies should be required to develop a robust due diligence system. OECD guidance provides important elements of such a system, including the OECD/FAO Guidance for Responsible Agricultural Supply Chains for companies handling forest risk commodities. Fourth, ensuring coherent enforcement across all EU Member States is critical. Fifth, penalties imposed for infringements must be dissuasive, possibly by linking penalties to the size of the company. Lastly, the legislation should apply to all companies throughout the supply chain, although care should be given to create a system that is workable for small companies. Certification should not serve as proof of compliance with the legislation.

It should be noted that there is a risk that companies may avoid liability for the harm they cause, simply by adopting due diligence plans while failing to take action to implement them effectively. Hence, any legislation should establish liability for companies in whose supply chains damage occurs. The development of a grievance and complaints mechanism should also be an integral part of the legislation.

All these conclusions need further research, analysis and discussion before they can be regarded as final. Equally, a debate on the criteria and exact company requirements for both forms of legislation is important and should further inform enforcement possibilities.



There is a risk that companies may avoid liability for the harm they cause simply by adopting due diligence plans while failing to take action to implement them effectively. Hence, any legislation should establish liability for companies in whose supply chains damage occurs.

Fern Office UK

1C Fosseyway Business
Centre, Stratford Road,
Moreton in Marsh,
GL56 9NQ, UK

Fern Office Brussels

Rue d'Edimbourg, 26,
1050 Bruxelles,
Belgium

www.fern.org