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The French 'Duty of Vigilance' Law: Lessons for an EU Directive on Due Diligence in Multinational Supply Chains

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Policy recommendations

The Rana Plaza tragedy demonstrated the need to regulate companies which use subsidiaries, subcontractors and suppliers to carry out underpaid work, without consideration for core humanitarian principles, including trade union and workers' rights. Structures permitting companies to profit from such abusive practices should be replaced by a principle of company responsibility for their entire value chain. A French law passed in 2017, which defines a 'duty of vigilance' for companies, provides important lessons for the drafting of an EU directive on due diligence. The duty of vigilance applies to human rights and fundamental freedoms, health and safety, and the environment. Going beyond a simple 'due diligence' obligation, it mandates companies to set up a 'vigilance plan' containing reasonable but adequate

measures to identify risks and to prevent severe impacts on such rights. A directive at the EU level on this issue should be adopted based on these principles. It should also contain appropriate internal monitoring arrangements (such as a 'vigilance committee' with stakeholder representation, including trade unions and worker representatives), proper external supervision (through a public supervisory agency) and adequate remedies, including criminal sanctions, disgorgement of profits, and punitive damages. The directive should apply to companies whose seat is in the EU as well as companies above a certain size threshold selling goods and services in the EU.

Introduction

Multinational companies frequently use subsidiaries, subcontractors and suppliers to carry out underpaid work, without consideration for human rights and fundamental freedoms, health and safety, and the environment (hereafter the 'core humanitarian principles'). Under national and international law, companies at the 'top' of the supply chain are generally not liable for violations of core humanitarian principles lower down in the chain. The Rana Plaza tragedy of 2013, in which 1,135 workers at supplier firms for European and North American apparel multinationals were killed when their unsafe building collapsed, clearly demonstrated that regulation is needed to impose an obligation on companies to take responsibility for practices along the supply chain.

In 2017, a law was passed in France compelling large French companies to address this issue through the creation of a 'duty of vigilance'. Although this law has some shortcomings that should be addressed, it could serve as a useful example for a directive at the EU level, which is currently under discussion. In a report on sustainable finance dated 4 May 2018, the European Parliament¹

called for the introduction of a mandatory due diligence framework based on the French Duty of Vigilance Law. This request followed the mandate given in the European Commission Action Plan on Financing Sustainable Growth of 8 March 2018² to address the same issue.

This policy brief will first review why it is important to impose a legal vigilance obligation on companies, before moving on to analyse the French Law. It then concludes by drawing some lessons from the French experience that are of relevance to the drafting of a directive at the EU level.

1 https://www.europarl.europa.eu/doceo/document/A-8-2018-0164_EN.html

2 https://ec.europa.eu/info/publications/180308-action-plan-sustainable-growth_en

Why do we need a directive to enforce a 'duty of vigilance' in companies?

The current world international order has been built on two sets of principles: on the one hand, core humanitarian principles, embodied in texts such as the 1948 Universal Declaration of Human Rights, the 1944 Declaration of Philadelphia, the nine core international human rights instruments, the International Labour Organisation (ILO) eight fundamental conventions, the ILO conventions regarding health and safety, the 2000 UN 'Global Compact' principles, and international environment agreements and treaties; and, on the other hand, economic principles, such as the freedom to trade or invest. However, when it comes to globalisation, it is the economic principles that are almost exclusively applicable, revealing a lack of coordination between these two sets of principles.

This failure can be traced to two core company law rules which are applied throughout the world:

- The principle of 'shareholders' limited liability' helps companies to avoid responsibility for the behaviour of subsidiaries: shareholders benefiting from abusive or damaging company practices cannot be sued or asked to indemnify for the damage. They essentially benefit from a legal immunity. This rule works as a 'double armour' to protect ultimate shareholders: liabilities incurred by subsidiaries are not passed on to the holding company at the helm of the group, and liabilities of the holding company are not transferred to its ultimate shareholders.
- The principle of 'legal autonomy' allows companies to avoid responsibility for abusive or damaging practices of suppliers and subcontractors. Companies essentially have the right to look the other way. This mechanism thus adds a third layer of protection for ultimate shareholders.

In order to truly coordinate the core humanitarian principles and main economic principles, the old Latin maxim should be applied: *'ubi emolumentum, ibi onus'*, or 'where the profit is, there is the liability'. A radical implementation of this concept would be to abolish the three components of the shareholders' direct and indirect immunity outlined above. However, this solution could have serious side effects on the functioning of the economy, in particular regarding its financing. As a result, a duty of vigilance obligation is a preferable option, as it creates a principle of company responsibility for overall production and is strongly justified by both its economic and ethical benefits.

From an economic standpoint, the duty of vigilance would address the following core issues:

- **Externalities:** Non-compliance with the core humanitarian principles creates negative externalities which are not included in the price of products. In most cases, no remedial taxation is possible as the company creating the externality is not located in the country suffering due to the externality. The duty of vigilance is thus a way to promote the internalisation of externalities.
- **Innovation:** Companies competing among themselves economically while complying with the core humanitarian principles will be pushed to innovate, in particular regarding sustainability of their products and processes.

- **Unfair competition:** In the absence of a level playing field, companies acting as 'good citizens' suffer from unfair competition. This is the reason why soft law is inadequate.
- **Loyalty:** Numerous consumers, workers and investors do not wish to be involved with serious violations of the core humanitarian principles. The enhanced transparency provided by the duty of vigilance would make it easier for them to stay away from companies responsible for such violations.

The two main ethical arguments supporting the need for regulation are the following:

- **Protection:** One of the anthropological functions of the law is the duty to protect the weaker party, such as the employees of suppliers in the Rana Plaza tragedy, against the misconduct or negligence of the stronger party, such as the multinational companies that hired those suppliers.
- **Equality:** Acknowledging the equal value of all human beings (the ancient Greek concept of *isotimia*) is one of the basic tenets of the human rights framework. As a result, the value of the workers in a subcontractor or supplier company is no less than the value of the consumers of the product they manufactured or the investor in the outsourcing company. *Isotimia* is thus greatly promoted by the duty of vigilance.

The French Duty of Vigilance Law

The French corporate Duty of Vigilance Law of 27 March 2017³ is arguably the most developed piece of legislation on the duty of a corporation regarding compliance with core humanitarian principles, by the company itself and by its subsidiaries, suppliers and subcontractors.

The law was adopted in the last days of the mandate of President François Hollande. It is largely the result of the work of a deputy, Dominique Potier, who in 2012 set up a cross-party working group involving Members of Parliament, NGOs and lawyers; during the whole legislative process, he was the 'rapporteur' for the bill at the Commission on Legal Affairs. Trade unions supported the proposal throughout the process. The draft, against which the business community lobbied intensely, was finally adopted by an almost unanimous vote of the National Assembly.

The law is applicable to the largest companies, defined as companies employing, together with their French direct and indirect subsidiaries, at least 5,000 workers, or employing, together with their French and foreign direct and indirect subsidiaries, at least 10,000 employees.

Such companies must establish a 'vigilance plan' containing reasonable but adequate measures to identify and prevent severe impacts on human rights and fundamental freedoms, on health and safety, and on the environment (i.e. the core humanitarian principles) resulting from the activities of the company and its direct and indirect subsidiaries, as well as the activities of subcontractors or suppliers with whom there is an established

3 Law inserted in Article L. 225-102-4 of the French Commercial Code.

commercial relationship (when these activities are related to this relationship).

In particular, the plan must include:

- a risk map;
- regular evaluation procedures regarding the situation of relevant subsidiaries, subcontractors and suppliers;
- adequate actions to mitigate risks or prevent severe impacts on areas covered by the core humanitarian principles;
- an alert mechanism regarding the existence or materialisation of risks, established in consultation with the trade unions considered as representative within the company (although the law is not specific, it is generally considered that the mechanism should be accessible to anyone and not restricted to employees);
- a system monitoring the measures implemented and evaluating their effectiveness.

Companies must follow three rules. The vigilance plan must be prepared in collaboration with the stakeholders of the company; the plan must be 'effectively implemented'; and the plan and a report on its implementation must be made public and included in the company's annual management report (which is submitted to the general meeting of shareholders). Statutory auditors do not review the plan or its implementation, except for information otherwise reported in the extra-financial reporting.

As a result, the duty of vigilance goes far beyond due diligence. Due diligence can be limited to the mere identification of risks, an exercise typically carried out once a year, while the duty of vigilance requires companies to identify and monitor risks and to act upon them through ongoing mitigation and prevention measures.

Assessment of the French Vigilance Law and the lessons it holds for the European Union

The Vigilance Law is still recent, but we have seen that the plans established by companies in the second year of application, although still imperfect, improved in comparison with the first year. There are four lessons to be drawn from the French Duty of Vigilance Law, three mostly positive and one negative (regarding governance). The proposals made below, in the context of these lessons, to improve the law could be directly applied to any directive that would introduce an EU-wide duty of vigilance obligation.

Scope

The Duty of Vigilance Law is rightly focused on large companies, which are the only ones with enough resources and leverage to implement the duty of vigilance.

However, the scope could be further widened with these three additions:

- A significantly simplified version of the duty should be imposed on small and medium companies (SMEs).
- The scope of the law should encompass all categories of companies (some forms are currently excluded). In addition, a

list of these companies should be made public and their plans made available on a specific website.

- The law should not be restricted to companies whose legal seats are based in France but also include foreign companies doing business in France. A good example of such a territorial scope is the United Kingdom Modern Slavery Act (2015), which applies to all companies providing goods and services in the UK.

Action

The Duty of Vigilance Law is satisfactory in that it imposes a 'duty of care' standard, not just a due diligence and reporting duty: this means companies have to actually act properly, not just report on whether they act properly.

The concept of asking companies to set up and publish their own vigilance plan, based on a primary assessment made by the company itself and its ability to prioritise such a plan in their operations, is a reasonable approach. However, assessments of the implementation of the law, in particular those done by various humanitarian organisations, show that two key concepts are missing:

- The law should provide that the most important individual risks should be described separately and in enough detail to understand the compliance parameters and processes; there should also be a more specific description of the use of suppliers or subcontractors in 'at risk' countries.
- The freedom left to companies in the presentation of their vigilance plans makes comparability difficult. The European Commission has acknowledged the importance of 'taxonomy' regarding this issue⁴ and in particular regarding the related topic of non-financial reporting.⁵ A public supervisory agency should thus be created and tasked with setting up norms in view of progressively standardising the presentation of plans and applying defined concepts. This should be a carefully staged process, based on large-scale reviews and discussions with all stakeholders. Just as standardised accounting rules took more than a century to be developed, these standards cannot be defined and implemented without the benefit of time.

Remedies and sanctions

Some useful remedies against abusive practices are provided for in the Duty of Vigilance Law. First, remedies are not limited to constituent parties of the company (i.e. employees, managers and shareholders) but also include the stakeholders of the entities targeted by the law (i.e. the suppliers and subcontractors). For instance, employees of a subcontractor, as well as trade unions and NGOs, may sue the company. No litigation has been initiated so far regarding the payment of damages, but there are several cases where litigation has been commenced or threatened when the vigilance plans were significantly deficient.

4 See 'Sustainable finance: TEG final report on the EU taxonomy', 9 March 2020, https://ec.europa.eu/knowledge4policy/publication/sustainable-finance-teg-final-report-eu-taxonomy_en

5 See the Inception Impact Assessment, <https://ec.europa.eu/info/law/better-regulation/have-your-say/initiatives/12129-Revision-of-Non-Financial-Reporting-Directive>

- Four sanctions are, however, lacking and should be added:
- Criminal sanctions for the most flagrant violations of the law, such as the lack of an established plan or monitoring process, or gross or wilful misrepresentation in the plan or the report on its implementation.
 - Disgorgement of profits made by the company through suppliers and subcontractors which are not compliant with the core humanitarian principles.
 - Punitive damages in the event of gross or wilful violation by the company of its duty of vigilance.
 - Exclusion of access to the EU market for suppliers and contractors found to violate the core humanitarian principles.

- More importantly, the informal process of 'associating' stakeholders with the establishment and implementation of the plan must be replaced by a 'vigilance committee'. This committee would need to have the following characteristics: (i) independence, meaning that their members should be appointed by the management, the employees and the shareholders (for instance, representing 40%, 40% and 20% respectively); (ii) adequate funding to carry out their mission (including for hiring experts); (iii) adequate legal means, through access to the relevant persons (management, auditors and employees) and documents, and (iv) the right to prepare and publish their own report on the compliance of the company with its vigilance duties.

The courts should also be authorised to reverse the burden of proof if certain criteria are met, for instance if the vigilance plan is so lacking in precision that it cannot be usefully utilised by the claimant to establish their rights.

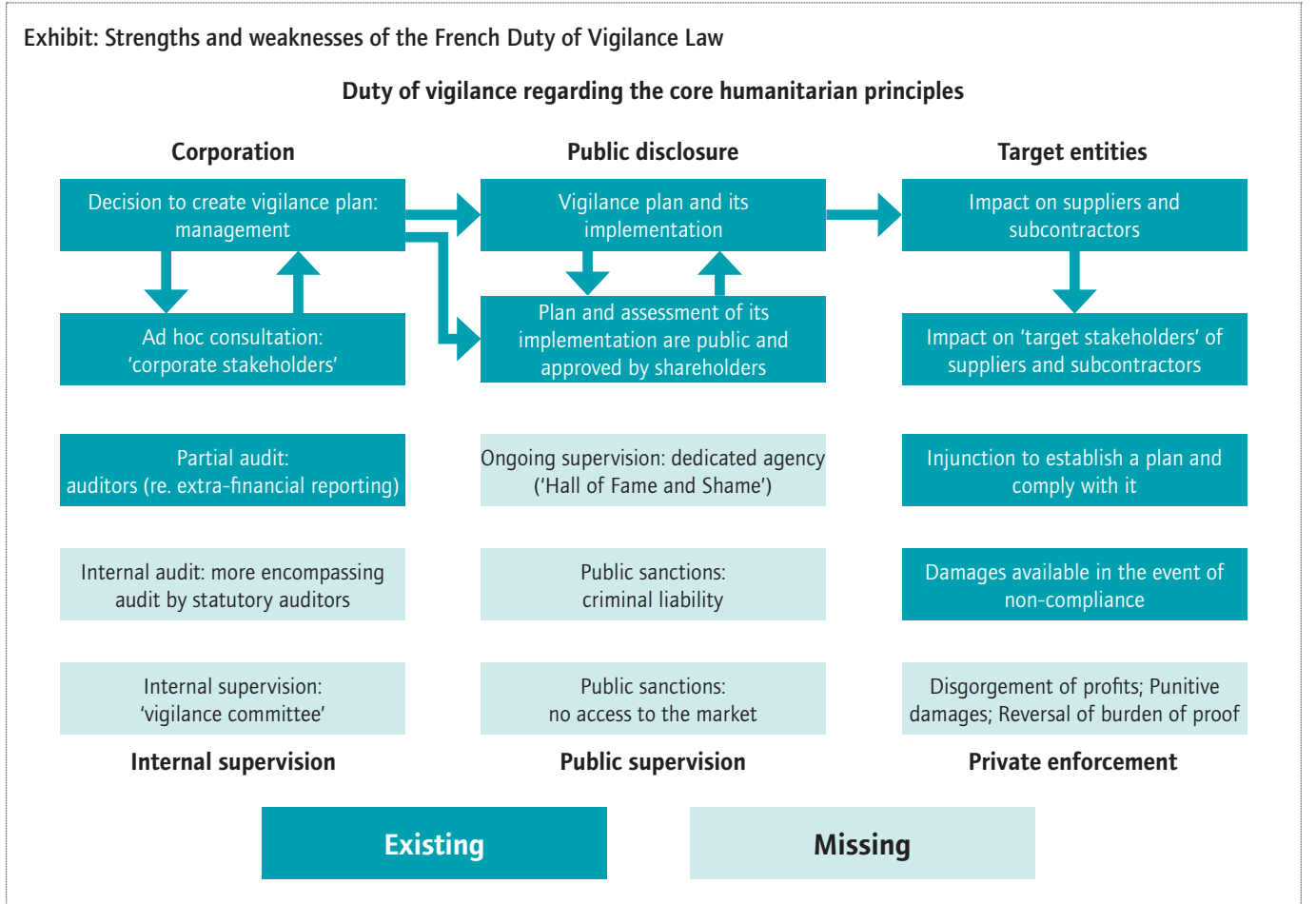
Governance and supervision

Proper governance and supervision mechanisms are lacking in the French Duty of Vigilance Law. As a result, many plans do not provide meaningful information.

- Internal supervision must be strengthened in two ways:
- Statutory auditors should carry out a far more encompassing review of the plan, which is currently only ever indirectly reviewed (when the plan includes items that are reviewed under other regulations, such as extra-financial reporting).

Public supervision is, moreover, entirely lacking in the French Law, and a public supervisory agency should thus be set up to carry out such a task. Just as financial or accounting supervisory agencies are instrumental in promoting norms and compliance in their respective fields, this new agency would promote worldwide compliance with the core humanitarian principles for companies falling under the scope of the Law's regulations. This agency could develop harmonised standards, promote best practices, accredit audit firms wishing to support companies in implementing their vigilance duty, propose templates and procedures for SMEs, enforce the rules and adopt additional rules where necessary, and set up accredited processes for the creation of blacklists and whitelists of suppliers and subcontractors.

The diagram below summarises the strengths and weaknesses of the French Duty of Vigilance Law.



Recommendations

It is thus recommended that a directive be adopted along similar lines as the French Vigilance Law, but with several amendments and additions. A directive should provide, in particular, for the six following features:

1. **Core mechanism:** Companies should adopt and apply vigilance plans designed to enforce core humanitarian principles throughout the production cycle, including in subsidiaries, suppliers and subcontractors. Core humanitarian principles should cover human rights and fundamental freedoms (including trade union and workers' rights), health and safety, and the environment.
2. **Scope:** The directive should apply to companies whose seat is in the EU as well as companies above a certain size threshold selling goods and services within the EU. A specific and much more simplified regime should be applicable to SMEs.
3. **Duty:** The duty of vigilance should go beyond a mere due diligence obligation. The 'vigilance plan' should mandate reasonable but adequate measures not only to identify risks but also to monitor them and to mitigate and prevent severe violations of core humanitarian principles.
4. **Internal supervision:** Auditors should be involved in the process. Stakeholders, including trade unions and worker representatives, must be proactively involved in shaping and monitoring the vigilance plan: an internal 'vigilance committee' should be set up to prepare the vigilance plan and monitor its implementation. This committee should be independent by design and be provided with the appropriate legal and financial means to carry out its duties. An alert mechanism must also be set up in the company.
5. **Public supervision:** A public supervisory agency should be set up to adopt standards, promote good practices, enforce the rules, and accredit processes for the establishment of blacklists and whitelists of suppliers and contractors.
6. **Liability and enforcement:** Companies should be accountable for the impacts of their operations. Liability must be introduced for cases where companies fail to respect their due diligence obligations, without prejudice to joint and several liability frameworks. A proper enforcement mechanism would need to include criminal sanctions, disgorgement of profits, punitive

damages, and exclusion of access to the EU market for suppliers and contractors found to violate the core humanitarian principles, as well as the ability for the courts to reverse the burden of proof in certain cases. Finally, effective remedies and access to justice should be available for victims, including trade unions.

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