The European Regulatory Approach on Supply Chain Responsibility

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Abstract

The article presents four categories of EU approaches on regulating supply chain responsibility. Sometimes, like in the case of the Kimberley process for conflict diamonds or with respect to illegally fished fishery products, the EU enacts restrictions or prohibitions that are specifically targeted at the import of foreign products. These import regimes are distinguished from marketing prohibitions for unethically produced goods. The prime examples are the European bans on cat and dog fur and seals products, as well as a possible future ban on goods made from forced labour. While these categories impose negative duties for EU importers and producers, the author also looks at EU regulations imposing positive obligations of EU companies. They may either be required to report about supply chain responsibility or need to entertain due diligence with respect to their import activities. For the latter category, the author discusses the EU regulations on tropical timber, conflict minerals, deforestation and general due diligence. *Hoffmeister* shows how these regimes fit into the normative framework of the European Union's foreign policy objectives and argues that they are WTO compatible. He also provides a short comparative assessment about their effectiveness.

Keywords: European Union, Due Diligence, Kimberley Process, Illegal Fishing, Market Prohibitions, Conflict Minerals, Bangladesh Compact, Tropical Timber, Deforestation, Commission Proposal on Sustainable Corporate Responsibility

A. Introduction

In 2021, the Europa-Institute of the University of *Saarbrücken* turned 70 years old. It gives me great pleasure to congratulate the Directors of the Institute, Prof.

Giegerich and Prof. Bungenberg, for their tireless efforts in keeping the Institute among the centres of excellence for doing research and teaching on European integration in its international dimension.

This article will present several EU approaches on regulating supply chain responsibility in their respective legal framework. It is suggested to group them into four categories, depending on the nature of the obligations imposed by the EU. In the first category of import regimes, the EU enacts restrictions or prohibitions that are specifically targeted at the import of foreign products (Section B). They are distinguished from marketing prohibitions for unethically produced goods, discussed in Section C. Here, an internal marketing ban for goods produced in the EU is supplemented by an import ban for similar goods produced outside the EU. In both categories, the companies are not allowed to engage in commercial activities related to the product concerned (negative duties). The other two categories relate to specific positive obligations of EU companies. They may either be required to report about their corporate social responsibility (Section D) or to entertain due diligence with respect to their activities (Section E).

In analysing the different regulatory regimes, a short assessment of how they fit into the normative framework derived from EU and international law is added in each section. Under Article 3(5) and 21(2) TEU, the European Union shall strive for "free and fair trade". Moreover, the Union shall promote its own values on the international scene (Article 21 (1) TEU) and foster a couple of specific foreign policy goals in its external relations.[1] Among the goals listed in Article 21 (2) TEU, the duty to promote human rights (lit. b), to preserve peace and prevent conflicts (lit. c), to foster sustainable development (lit. d) and to improve the quality of the environment and the sustainable management of global natural resources (lit. f) are particularly important. At the same time, as a Member of the WTO, it must observe its commitments deriving from the GATT. In particular, it shall grant most-favoured nation treatment, national treatment and shall not enact import bans, unless justified by policy grounds laid down in Articles XX and XXI GATT.[2] During the analysis, relevant justifications of the different regimes are put forward.

In the conclusion, I will also provide a comparative assessment about the effectiveness and WTO compatibility of the respective instruments.

B. Import regimes

Strong European regulatory approaches are import regimes, which eliminate or restrict certain foreign goods from entering the EU market for policy reasons. While it is impossible to summarize all EU import regimes with an impact on supply-chain flows, two important examples can be highlighted where the EU has curtailed imports to support international regimes intervening in the supply chain. The first example is the Kimberley process, which is motivated by considerations to preserve

1 See the contribution of *Thomas Giegerich* in this issue.
2 See the contribution of *Jelena Bäumler* in this issue.

international peace and security, while the second example on illegal, unregulated and unreported fishing relates to the sustainable management of resources.

I. The Kimberley process

1. EU background

The Kimberley process is a multilateral trade regime, which entered into force in 2003. Discussions on how to stop diamond purchases fuelling violent rebel movements had already started in 2000, when Southern-African diamond-producing states met in Kimberley, South Africa.[3] On 5 July of the same year, the United Nations Security Council expressed concern "at the role played by the illicit trade in diamonds in fuelling the conflict in Sierra Leone".[4] Acting under Chapter VII, the Security Council demanded States to prohibit the import of rough diamonds from Sierra Leone.[5] At the same time, the Resolution 1306 (2000) exempted imports of rough diamonds whose origin was certified by the Government of Sierra Leone,[6] and it encouraged the diamond industry to cooperate with the ban. After two more years of deliberations, on 5 November 2002 at the Interlaken meeting, most States involved in such trade decided to launch the Kimberley Process Certification Scheme beginning 1 January 2003.[7] By Resolution 1459 (2003), the Security Council "strongly supported" the scheme.[8] Nowadays, 56 participants representing 82 countries participate in the Kimberley Process, accounting for more than 99% of the global rough diamond production and trade.[9]

The Kimberley Process Certification Scheme defines conflicts diamonds as "rough diamonds used by rebel movements of their allies to finance conflict aimed at undermining legitimate governments, as described in relevant United Nations Security Council (UNSC) resolutions (…)". It is based on a tripartite structure, involving governments, industry and civil society. The Scheme is used by States to implement safeguards on shipments of rough diamonds and certify them as "conflict-free". Under the terms of the Certification Scheme, participants are required to:

- Satisfy "minimum requirements" of the agreement and establish national legislation, institutions and import/export control;
- Commit to transparent practices and to the exchange of critical statistical data;

3 See https://www.kimberleyprocess.com/en/about (14/3/2022).
4 UNSC Resolution 1306 (2000), Preamble, First consideration.
5 UNSC Resolution 1306 (2000), First operational paragraph.
6 UNSC Resolution 1306 (2000), Fifth operational paragraph.
7 Interlaken Declaration of 5/11/2002 on the Kimberley Process Certification Scheme for Rough Diamonds, available at: https://www.kpcivilsociety.org/wp-content/uploads/2019/10/KP-InterlakenDeclaration-KPCS-1102.pdf (14/3/2022).
8 UNSC Resolution 1459 (2003), First operational paragraph.
9 See https://ec.europa.eu/fpi/what-we-do/kimberley-process-fight-against-conflict-diamonds_en (14/3/2022).

- Trade only with other participants in the scheme;
- Certify shipments as conflict-free and provide the supporting certification.

The European Union and its Member States, represented by the European Commission, count as a single participant in the Kimberley Process Participation Scheme. Based on Article 133 TEC (now Article 207 TFEU), Council Regulation (EC) 2368/2002 of 20 December 2002 "implementing the Kimberley Process certification scheme for the international trade in rough diamonds" defines common rules for all Member States.[10] According to Article 3, the import of rough diamonds into the Community (now Union) is prohibited unless all the following conditions are met:

- the rough diamonds are accompanied by a certificate validated by the competent authority of a participant;
- the rough diamonds are contained in tamper-resistant containers, and the seals applied at export by that participant are not broken;
- the certificate clearly identifies the consignment to which it refers.

Any import or export of rough diamonds into or from the EU can only be done through one of the seven Union authorities present in Belgium, Czech Republic, Germany, Ireland, Italy, Portugal and Romania. If a Union authority exists neither in the importing Member State nor in the Member State of destination, the importer can choose to which Union authority it will submit the shipment and certificate, for verification. All details of rough diamond shipments are recorded on a computerized database and reported to the European Commission as the Kimberley Process authority on a monthly basis in accordance with Article 15 of the Regulation. Since the Kimberley Process was put in place, the identifiable trade in conflict diamonds is estimated to have come down from 15% in 2003 to less than 1% in 2018.[11] Under the Instrument contributing to Stability and Peace (IcSP), the EU is also funding activities in Cote d'Ivoire, Guinea, Liberia, Sierra Leone and Central African Republic to support the implementation of the Kimberley Process.[12]

Since 2002, Council Regulation (EC) No 2368/2002 has been substantially amended several times. Since further amendments are required, the European Commission submitted a proposal on 12 March 2021 for a Regulation of the European Parliament and of the Council implementing the Kimberley Process Certification Scheme for the international trade in rough diamonds (2021/0060 COD),[13] which

10 OJ L 358/28 of 31/12/2002.

11 *European External Action Service (EEAS)*, Speech by Hilde Hardeman, Kimberley Process Chair for 2018 at the Diamond Session of the 2018 OECD Forum on responsible mineral supply chains, Paris, 18 April 2018, Youtube, 8/5/2018, available at: https://www.youtube.com/watch?v=5ywy4md3mO8 (14/3/2022), 00:51 to 01:08.

12 See the IcSP map, available at: https://icspmap.eu/pdf/?format=single&contract_number=407483 (14/3/2022).

13 Proposal for a Regulation of the European Parliament and of the Council implementing the Kimberley Process certification scheme for the international trade in rough diamonds (recast), COM/2021/115 final.

re-casts Council Regulation (EC) No. 2378/2002. The purpose of the proposal is to undertake a codification of amendments to the current EU Regulation; the new regulation will supersede the various acts incorporated in it, while fully preserving the content of the acts being codified.

2. WTO compatibility

While the scheme supports the EU's foreign policy goal to reduce international conflicts (Article 21 (2) (c) TFEU) by "drying out" the financing for rebel movements, its WTO justification is less straightforward. At first sight, the import ban for diamonds that are not properly certified is at odds with the obligation to grant most-favoured-nation treatment (Article I:1 GATT) and the prohibition of operating quantitative restrictions in a discriminatory manner under Articles XI and XIII GATT. However, the Security Council enacted the import ban for rough diamonds back in 2000 under Chapter VII as a legally binding decision on all UN States. Therefore, it can be maintained that the EU and its Member States comply with an "obligation under the UN Charter for the maintenance of international peace and security" under Article XXI (c) GATT when they operate the Kimberley certification scheme. The import restrictions are therefore justified for legitimate security reasons.

Nevertheless, and removing any potentially remaining doubt on the WTO compatibility of the scheme, the WTO General Council adopted a waiver from GATT rules for trade measures taken under the Kimberley Process Certification Scheme on 15 May 2003. The waiver decision exempts 11 members[14] and other members that would subsequently join from GATT provisions on most-favoured-nation treatment (Article I:1), elimination of quantitative restrictions (Article XI:1) and non-discriminatory administration of quantitative restrictions (Article XIII:1).[15] The first waiver had retroactive effect from 1 January 2003 until 31 December 2006. It was constantly updated and extended, and more countries were included over the years. Extensions were granted in 2006,[16] 2012,[17] and the latest one of 2018 applies until 31 December 2024.[18]

14 Australia, Brazil, Canada, Israel, Japan, Korea, Philippines, Sierra Leone, Thailand, United Arab Emirates and United States.

15 Decision of the General Council of 15/5/2003, Waiver concerning Kimberley Process Certification Scheme for Rough Diamonds, WT/L/518, dated 27/5/2003.

16 Decision of the General Council of 15/12/2006, Kimberley Process Certification Scheme for Rough Diamonds, WT/L/676, dated 16/12/2006.

17 Decision of the General Council of 14/12/2012, Extension of waiver concerning Kimberley Process Certification Scheme for Rough Diamonds, WT/L/876, dated 11/12/2012.

18 Decision of the General Council of 30/7/2018, Extension of waiver concerning Kimberley Process Certification Scheme for Rough Diamonds, WT/L/1039, dated 26/7/2018.

II. The European regulation on illegal, unreported or unregulated fishing

1. EU background

The second example relates to the EU regulation 1005/2008 on illegal, unreported or unregulated fishing (IUU fishing).[19] Adopted under (ex) Article 37 TEC, the EU hereby stepped up the fight against overfishing in the high seas. Next to a system of inspection of third country vessels in EU ports, the regulation introduced a restrictive trading system. Under Article 12(1) of the regulation, the importation of fishery products obtained from IUU fishing is prohibited, unless accompanied by a catch certificate validated by the flag State. The flag State must certify that the catches have been made "in accordance with applicable laws, regulations and international conservation and management measures" (Article 12(3) of the Regulation). Such national catch certificates can be replaced by certificates emanating from a regional fisheries organization if they comply with the standards of the Regulation (Article 13 of the Regulation). Importantly, the certification requirement is also extended to "indirect trade", i.e. fishery products from other States which are processed or transported by another State than the flag State before they reach the Union market (Article 14 of the Regulation).

Moreover, an even more drastic trade restriction may be applied if the EU determines that a third country is not cooperating in the fight against IUU practices. After a warning ("yellow card") the EU may put a third country on a black list ("red card"). Such listing triggers an import prohibition for any fisheries product of that country, associated with a prohibition of EU vessels operating in its waters (Article 38 of the Regulation).

While the trade regime is straightforward in theory, its practical impact is hard to assess. However, it can be safely maintained that the IUU system as a whole, including the multiple step approach of the EU in dealing with non-cooperative countries, has improved the sustainability of the international fisheries practices. According to an EP report of 2021, the Commission has identified more than 50 non-cooperating states in the last decade, out of which six received the red card. Three of them were delisted after 13, 20 and 35 months, respectively.[20] In 2021, 8 countries continued to have yellow card, and three suffered from total import prohibitions due to a red card. These figures imply that the other over 40 countries reacted positively to the EU concerns. This means that they were able to show that they have stepped up their national practices in controlling IUU fishing considerably after extensive dialogues with the EU.

19 Council Regulation (EC) 1005/2008, OJ L 286/1 of 29/10/2008.

20 *European Parliament Research Service*, Illegal, Unreported and Unregulated Fishing, Infographic of March 2021, p. 2.

2. WTO compatibility

Clearly, the purpose of this scheme is to ensure the sustainable management of marine resources worldwide. Under the Regulation's first recital, the EU recalls its obligation stemming from the 1982 UN Convention on the Law of Seas, the 1995 UN Straddling Stocks Convention and the 1993 FAO Compliance Agreement. Under EU law, this fits well into the foreign policy objective of Article 21 (2) (f) TEU to improve the sustainable management of global natural resources worldwide. Under WTO law, such import restrictions must, however, be justified under Article XX GATT. Article XX (g) GATT allows import restrictions if they are

> relating to the conservation of exhaustible natural resources if such measures are made effective in conjunction with restrictions on domestic production or consumption;

The first question is hence whether marine resources in the high seas are "exhaustible" natural resources or whether the notion is restricted to "non-living" resources, such as minerals. In the US-Shrimps case, the Appellate Body rejected a restrictive reading and opined that "living resources" are just as "finite" as petroleum, iron ore or other non-living resources.[21] For that view, it referred to the preamble of the WTO Agreement, which refers to the objective of sustainable development as one of the WTO's goals.[22] While the Appellate Body did not take an express position about potential "jurisdictional limits" in Article XX (g) GATT,[23] it nevertheless did not question the legality of the US statute which was protecting the sea-turtles by a restrictive import regime on shrimps, whose industrial catch endanger the turtles. In that respect, it found a sufficient nexus between the migratory species of turtles which might pass between the US exclusive economic zone and the high seas. For the EU, a similar argument can be advanced easily. Some of the protected fish in the high seas may also have crossed into some of the EU's exclusive zones. Moreover, implementing UN obligations against overfishing in the high seas is perfectly in line with the WTO's preamble that trade rules should not be detrimental to sustainable development. Hence, in line with a dynamic reading of the WTO agreement, Article XX (g) GATT may hence also refer to the entire population of the high seas, which are threatened by depletion through overfishing.

The second question is whether the EU import regime under the IUU regulation is "relating to" the conservation of such resources. Clearly, as part of a broader regulation aimed at deterring IUU fishing, it is primarily aimed at achieving this policy goal in a complementary manner.

The third question warrants an inquiry as to whether the import restrictions are made "in conjunction with domestic restrictions". In that respect, it must be shown that the EU regime on IUU fishing equally applies to EU vessels. As Articles 12-14

21 Appellate Body Report of 12/10/1998, WT/DS58/AB/R, p. 47, para. 128 (US-Shrimps).
22 Ibid., paras. 129–131.
23 Ibid., para. 133: "We do not pass upon the question of whether there is an implied jurisdictional limitation in Article XX(g), and if so, the nature or extent of that limitation".

of the Regulation subject EU Member States to the same obligations as any foreign flag State, that criterion is also fulfilled.

It can be concluded that the IUU regime is a primordial example of an EU measure regulating the international supply chain for fisheries products, which implements the EU foreign policy objectives to foster sustainability while respecting the EU's WTO obligations.

C. Marketing prohibitions

A second instrument regulating supply chain responsibilities in the EU are marketing prohibitions for products whose production process is unethical. Two famous examples are the EU bans on dog and cat fur products and on seal products. In the future, another ban on products made by forced labour might follow.

I. The European ban on dog and cat fur and products containing such fur

1. EU background

A marketing ban exists in the Union for dog and cat fur and products containing such fur. Regulation 1523/2007 prohibits the marketing of these goods on the EU internal market and complements the ban with an import and export ban. The relevant recitals explain:

(11) There is no tradition of rearing cats and dogs for fur production purposes in the Community, although instances of manufacturing cat and dog fur have been noted. It appears in fact that the vast majority of cat and dog fur products in the Community originate from third countries. Thus, in order to be more effective, the ban on intra-Community trade should be accompanied by a ban on imports of the same products into the Community. Such an import ban would also respond to concerns expressed by consumers as to the possible introduction into the Community of fur from cats and dogs, especially since there are indications that those animals may be kept and slaughtered inhumanely.

(12) A ban on exports should also ensure that cat and dog fur, and products containing such fur are not produced in the Community for export.

The only exception to this strict regime is an empowerment for the Commission to allow the placing on the market or import for "educational or taxidermy purposes" (Article 4). In that case, cat or dog fur is preserved for study or display after the animal died in a scientific context.

2. WTO compatibility

From a WTO perspective, the complete marketing and import ban makes sure that domestic and imported products are subject to the same conditions. Hence, the

regime is in compliance with the national treatment obligation under Article III:4 GATT and does not need to be justified under Article XX GATT.

II. The European ban on marketing seals products

1. EU background

Based on Article 95 EC (now Article 114 TFEU), the EU also outlawed the marketing of seal products because of the cruel hunting methods involved, creating high suffering for the animals. Regulation 1007/2009, though, created some exceptions. Among them were seal products derived from traditional hunting of the Inuit (Article 3 (1)) and those coming out of sustainable management of marine resources in order to control the size of the seal population (Article 3 (2) (b)).

2. WTO compatibility

In the opinion of Norway and Canada, the EU seals regime was not in line with the EU's WTO obligations. For them, the exceptions favoured Greenland (a part of Denmark) over themselves in trading seal products. Moreover, the exception for sustainable management of marine resources was another way of helping seal products from Finland and Sweden to enter the markets. The Appellate Body agreed that the EU regime violated the MFN principle under Article I:1 GATT, as the exceptions were an "advantage" which should have been given to all WTO members.[24] Importantly, the AB then assessed whether the exceptions could be justified under the "public morals" exception in Article XX (a) GATT. It accepted that the protection of seals was a particular EU concern, even if those animals lived outside the EU's jurisdiction.[25] Moreover, a marketing prohibition was "necessary" to respond to such European values of animal welfare as a certification scheme was not considered to constitute a reasonable alternative.[26] Nevertheless, the AB faulted the EU under the *chapeau* of Article XX GATT, as the implementation of the program was discriminatory. In particular, the EU was unable to show why animal welfare concerns led to the distinction between outlawed "commercial hunts" and acceptable "Inuit and sustainable management hunts".[27] In reply, the EU then abolished the exception for regular control measures for sustainable management needs and reduced the Inuit-exception by Regulation 2015/1775.[28]

24 Appellate Body Report of 20/5/2014, *EC-Seals*, WT/DS400/AB/R and WT/DS401/AB/R, paras 5.84–5.96.
25 Ibid., para. 5.173. As the parties did not address the question whether Article XX(a) contains an implied jurisdictional limitation, the Appellate Body did not examine this question. As a consequence, the EU was not faulted for its contention to protect also seals outside its jurisdiction.
26 Ibid., paras. 5.265–5.280.
27 Ibid., paras. 5.316–5.339.
28 OJ L 262/1 of 7/10/2015.

III. The forthcoming European marketing ban for goods derived from forced labour

1. EU background

On 26 November 2020, the European Parliament adopted a resolution on the EU Trade Policy review.[29] This document aimed at influencing the forthcoming Trade Policy Strategy from Executive Vice-President Dombrovskis, which was eventually adopted in February 2021. The EP expressed deep concern about the "reported exploitation of Uyghurs in factories in China", and stressed that "products produced in re-education camps should be banned from EU markets".[30] A month later, on 17 December 2020, it further elaborated on the issue in a full resolution dedicated to the sole issue of "forced labour and the situation of the Uyghurs in the Xinjiang Uyghur Autonomous Region".[31] In the resolution, the Parliament condemned the Chinese government-led system of forced labour, and the fact that well-known European brands and companies have been benefitting from the use of forced labour, pushing to conduct independent audits of human rights compliance in their full supply chains. It therefore called for a legislative proposal on human rights and environmental due diligence.[32] Moreover, it made a link to the EU-China investment agreement and demanded that China ratifies ILO Conventions No. 29 and 105 before Parliament approves the text.[33] Finally, it urged the Commission "to devise and implement a holistic EU strategy with a view to securing genuine progress on human rights in China".[34]

On the latter point, developments moved very quickly. On 7 December 2020, the Council of the European Union had just adopted a new sanctions regime allowing it to take restrictive measures against legal and natural persons involved in serious human rights violations.[35] Based on this new statute, the European Union (like the United States, the United Kingdom and Canada) decided to impose sanctions on Chinese officials for human rights abuses in Xinjiang.[36] Beijing hit back immediately with punitive measures against ten individuals and four entities in the EU, including Members of the European Parliament and of the Council's Political and Security Committee.[37] As a reply, the European Parliament voted to suspend

29 European Parliament Resolution of 26/11/2020, available at: https://www.europarl.europa.eu/doceo/document/TA-9-2020-0337_EN.html (14/3/2022).
30 Ibid., § 14.
31 EP Resolution of 17/12/2020, available at: https://www.europarl.europa.eu/doceo/document/TA-9-2020-0375_EN.html (14/3/2022).
32 Ibid., § 15.
33 Ibid., § 17.
34 Ibid., § 19.
35 CFSP Decision 2020/1999 and Regulation (EU) 2020/1998, OJ L 410 I, of 7/12/2020.
36 CFSP Decision 2021/481 and Regulation (EU) 2021/478, OJ L 99 I of 22/3/2021.
37 *Ministry of Foreign Affairs of the People's Republic of China*, Foreign Ministry Spokesperson Announces Sanctions on Relevant EU Entities and Personnel, 22/3/2021, available at: https://www.fmprc.gov.cn/mfa_eng/xwfw_665399/s2510_665401/2535_665405/202103/t20210322_9170814.html (14/3/2022).

ratification efforts of the Comprehensive Agreement on Investment (CAI) with China on 20 May 2021.[38] In the resolution, the Parliament also highlighted the urgent need to rebalance EU-China relations, calling for "supply-chain legislation with mandatory due diligence requirements which also provide for an import ban on forced labour goods".[39]

During her 2021 State of the Union Address of 15 September 2021, EU Commission President Ursula von der Leyen announced the European Commission's intention to introduce "a ban on products in our markets which have been made by forced labour".[40] This political commitment will most likely translate into a general marketing prohibition, accompanied by an import ban. Hence, European companies are well advised to start reviewing their supplies from all parts in the world with a significant risk that forced labour is involved in the production process. Against that background, the Commission and the EEAS published a voluntary due diligence guidance in July 2021 to help EU companies to address the risk of forced labour in their operations and supply chains, in line with international standards.[41] In response, the European Parliament requested on 16 September 2021 in its resolution on a new EU-China strategy to "swiftly finalise a supply chain business advisory with guidance for companies on the exposure to risks of using Uyghur forced labour and providing support in urgently identifying alternative sources of supply".[42] The political attention to this file is likely to continue given that US President Biden signed the Uyghur Forced Labour Prevention Act on 23 December 2021. That Act bans the import of a product originating in Xianjing if the legislative presumption that it is made from forced labour cannot be rebutted.[43]

2. WTO compatibility

Like in the case of the cat and dog fur ban, no particular justifications under WTO law need to be invoked if the future EU ban would similarly apply towards domestic and imported goods. Even if a *de facto* discrimination towards certain third states were to be alleged, two exceptions are likely available. The EU could argue that products made by forced labour can be equated to products made by prison

38 European Parliament Resolution of 20/5/2021, available at: https://www.europarl.europa.eu/doceo/document/TA-9-2021-0255_EN.html (14/3/2022), § 10.

39 Ibid., § 11.

40 *Commission President Ursula von der Leyen*, State of the Union Speech, 15/9/2021, available at: https://ec.europa.eu/info/sites/default/files/soteu_2021_address_en_0.pdf (14/3/2022), p. 15.

41 *European Commission and European External Action*, Guidance on Due Diligence for EU Businesses to address the risk of forced labour in their operations and supply chains, 7/7/2021, available at: https://trade.ec.europa.eu/doclib/docs/2021/july/tradoc_159709.pdf (14/3/2022).

42 European Parliament Resolution of 16/9/2021, available at: https://www.europarl.europa.eu/doceo/document/TA-9-2021-0382_EN.html (14/3/2022), § 13.

43 See https://www.reuters.com/world/us/biden-signs-bill-clamp-down-products-chinas-xinjiang-2021-12-23/ (14/3/2022).

labour covered by Article XX (e) GATT, or, it could maintain that the prohibition of forced labour falls under the public morals exception under Article XX (a) GATT.

D. Mandatory Reporting on Corporate Social Responsibility

A third regulatory approach developed in the last decade in the EU refers to mandatory reporting on corporate social responsibility. Back in 2011, the Commission presented a strategy for corporate social responsibility. In that document it propagated a "modern understanding" of CSR, defining it as the "responsibility of enterprises for their impacts on society".[44] Among the action plan for the next four years figured also the idea to improve company disclosure of social and environmental information by means of a legislative proposal at EU level to require more transparency, while ensuring a level playing field between companies in the EU.[45]

The outcome of this initiative was the adoption of Directive 2014/95 on non-financial reporting, which enlarges the yearly reporting obligations of large companies.[46] Under the *chapeau* of the new Article 19(a)(1),

> Large undertakings which are public-interest entities exceeding on their balance sheet dates the criterion of the average number of 500 employees during the financial year shall include in the management report a non-financial statement containing information to the extent necessary for an understanding of the undertaking's development, performance, position and impact of its activity, relating to, as a minimum, environmental, social and employee matters, respect for human rights, anti-corruption and bribery matters.

Importantly, Article 19(1)(b) also mandates to report about the policies pursued by the undertakings in these fields, "including due diligence processes implemented". This should foster the culture of transparency and accountability regarding supply chain governance in private businesses. Companies have an incentive to present the special steps to improve their supply chain responsibilities to the public and its shareholders. Being obliged to present an annual update, they may also have to improve their internal attention to these topics and hire due diligence experts to monitor this topic as a constant feature.

However, the Directive only applies to a limited amount of companies ('public interest entities' with over 500 employees) and does not provide much detail on the concrete reporting standards applicable to those companies. Against that background, the Commission adopted a proposal for a Corporate Sustainability Reporting Directive (CSRD) in April 2021, which would amend the existing reporting re-

44 A renewed EU strategy 2011-14 for Corporate Social Responsibility: Commission communication of 25/10/2011, COM (2011)681 final, p. 6.
45 Ibid., p. 12.
46 OJ L 330 of 13/12/2017.

quirements.[47] The proposal aims to extend the scope of sustainability reporting to all large companies (whether they are listed or not), and to all listed SMEs.

Seen from a WTO perspective, this soft regulatory approach to require companies reporting on corporate social responsibility in their annual statements does not pose any particular problems. It is directed at EU companies in the EU internal market and has no direct impact on trade flows from foreign countries.

E. European Due Diligence Regimes

Finally, the EU has also started enacting stronger due diligence regimes. In the fields regulated, the non-compliance with due diligence obligations will have an impact on the capacity of a company to import certain goods. These due diligence regimes hence constitute the fourth regulatory approach of the Union.

I. The EU Tropical Timber Due Diligence Regime

1. EU background

In 2003, the EU published a "Forest Law Enforcement, Governance and Trade Action Plan" (FLEGT). In that plan, several measures are listed to tackle the illegal logging of the most valuable forests in the world. One of the pillars is to promote legal trade in timber and to repress illegal activities. Against that background, the first European due diligence regime was adopted in 2010 with respect to Tropical Timber. Based on the Treaty's environmental chapter (then Article 192 (1) EC), Regulation (EU) No. 995/2010 makes sure that timber and goods derived therefrom (such as paper) can only enter the European market if it is harvested in line with the domestic law of the exporting country.[48] Hence, there is a need that traders trace the supply chain (Article 5). Operators, who place the timber on the EU market, shall exercise a due diligence system (Article 6). The key principles thereof are information, risk assessment and risk mitigation. If it cannot be shown that the good is derived from legal logging, it cannot enter the market (Article 4 para. 1) and the national authorities are required to impose dissuasive penalties (Article 19).[49]

In the absence of internationally agreed guiding principles on the matter, the EU has also made an effort to deal with the most affected partner countries on a bilateral basis. It has thus negotiated "Voluntary Partnership Agreements" (VPAs) with several timber-producing countries foreseen in the FLEGT regulation 2173/2005, establishing a special licensing regime.[50] These VPAs define "legal timber" accord-

47 Proposal for a Directive of the European Parliament and of The Council amending Directive 2013/34/EU, Directive 2004/109/EC, Directive 2006/43/EC and Regulation (EU) No 537/2014, as regards corporate sustainability reporting, COM/2021/189 final.

48 OJ L 295/23 of 12/11/2010.

49 For a highly informative presentation of the German enforcement practice see the article of *Dieter Lang* in this issue.

50 OJ L 347/1 of 30/12/2005.

ing to the regulatory framework of the exporting country. Moreover, a consignment destined for the EU can receive a "FLEGT" license if the standards are met. If an importer can produce such a license to an EU customs authority, the product can enter the EU market freely (Article 3 and Recitals 7-9). In other words: the VPAs are designed to improve the logging standards in the exporting countries, secure employment there for legal logging activities, and also produces more legal certainty for EU importers.

In practice, though, the results are mitigated. A study commissioned by the European Parliament found:[51]

> VPAs have increased cooperation between the EU and many producer countries. Bilateral negotiations and capacity building have sparked major legal and institutional reforms. In addition, owing to the inclusive participatory approach, a greater acceptance of the laws is expected, which will in turn lead to better implementation and enforcement. However, after eighteen years, only Indonesia has reached a level that was deemed sufficiently satisfactory to issue FLEGT licenses. Yet, weak governance, requirements and challenges with enforcement still need to be addressed to make the Indonesian VPA a truly effective instrument for ensuring legal compliance and stopping deforestation.

2. WTO compatibility

At first sight, it seems that the Tropical Timber Regime is an import regime tackling foreign timber, raising an issue under Article XI GATT.[52] However, a closer examination of its design leads to a different analysis. Article 6(1) of the Regulation contains a general marketing prohibition, where operators of both foreign produced timber as well as of timber from inside the EU must show that their product was logged in line with national law. Therefore, the EU regime must rather be measured against the national treatment provision under Article III:4 GATT. In that respect, the only worry may be that the due diligence requirements are applied in a less strict manner towards domestically harvested timber, when compared to timber imported from high-risk countries.[53] However, such a de-facto discrimination cannot be generally be assumed and must be shown in the practice of a particular EU regulator before mounting a WTO challenge on this basis. Against that background, a violation of Article III:4 GATT is unlikely.[54]

The second potential WTO challenge lies in the fact that the import guarantees for a VPA country may be applied selectively. That could amount to an infringement of most-favoured nation clause under Article I:1 WTO, as the "advantage" is not extended to other trading partners of the EU. However, the design of the regulation's relevant chapter already speaks against such hypothesis. All tropical timber

51 *Kindji*, EP Study, p. 10.
52 *Geraets/Naetens*, KU Leuven Working Paper 2013/120, pp. 10–11.
53 *Fishman/Obidzinski*, RECIEL 2014/2, p. 266.
54 *Geraets/Naetens*, KU Leuven Working Paper 2013/120, p. 15.

countries are eligible for a FLEGT license, and the conclusion of a VPA is based on objective criteria, namely a country's capacity to operate a legality verification system.[55] Accordingly, it seems far-fetched to allege discrimination on the basis of the fact that, since 2016, only Indonesia has been able to issue FLEGT licences. Other VPAs have namely been concluded with Ghana, Cameroon, Central African Republic, Liberia and Vietnam, and more negotiations are ongoing with other countries.[56]

II. The EU Conflict Minerals Regulation

1. EU background

The second EU regime relates to "conflict minerals" and dates back to an initiative of the then EU Trade Commissioner Karel De Gucht. The former Belgian Commissioner was very concerned about the role of certain minerals, including gold, in the ex-Belgian colony of Congo. Having convinced the then High Representative for Foreign Affairs and Security Policy, Mrs. Ashton, the Commission put forward a proposal based on the EU's trade powers (Article 207 TFEU) in 2014.[57] It foresaw a Union system for supply chain due diligence and *self-certification* of responsible importers of tin, tantalum, tungsten, their ores, and gold originating in conflict-affected and high-risk areas. However, during the negotiations, the Parliament insisted on turning the voluntary system into a *mandatory* system for upstream and downstream companies. The co-legislators approved the text in 2017, and the European Conflict Minerals Regulations 2017/821 entered into force on 1 January 2021.[58]

The Regulation applies to *four minerals*, namely tin, tantalum, tungsten and gold. In politically unstable areas, the trade of these so-called "conflict minerals" (often referred to as 3TG) can be used to finance armed groups, support corruption and money laundering, and fuel human rights abuses. While nickel, natural graphite, cobalt and lithium are also often linked to armed conflicts and related human rights abuses, they are excluded from the Regulation. In that choice, the EU followed the US example, as the US Dodd-Frank Act Wall Street Reform and Consumer Act of 2010 covers the same four products.[59]

55 For a similar line of reasoning under the *chapeau* of Article XX GATT see *Geraets/Naetens*, KU Leuven Working Paper 2013/120, pp. 20–22.

56 *European Commission*, FLEGT Regulation and VPAs, available at: https://ec.europa.eu/environment/forests/flegt.htm (14/3/2022).

57 Proposal for a Regulation of the European Parliament and of the Council setting up a Union system for supply chain due diligence self-certification of responsible importers of tin, tantalum and tungsten, their ores, and gold originating in conflict-affected and high-risk areas, COM/2014/0111 final – 2014/0059 (COD).

58 OJ L130/1 of 19/5/2017.

59 H.R.4173 – 111th Congress (2009-2010): Dodd-Frank Wall Street Reform and Consumer Protection Act., 21/7/2010, available at: https://www.congress.gov/bill/111th-congress/house-bill/4173/text (14/3/2022), Sect. 1502, p. 844.

While the material scope of the European and American scheme is thus comparable, there is an important difference on the geographic scope. According to Article 2(f) of the European Regulation, the areas considered conflict-affected or high-risk are those areas which are either suffering from armed conflicts such as civil war, or are in a state of fragile post-conflict, or are witnessing weak or non-existing governance and systematic violations of international law, including human rights abuses. In contrast, Section 1502 of the Dodd-Frank Act is limited in coverage only to Central African countries.

Turning to the substantive obligations of due diligence, the EU Conflict Minerals Regulation has largely been based on the OECD Due Diligence Guidance for Responsible Supply Chains of Minerals from Conflict-Affected and High-Risk Areas.[60] The Regulation thus requires importers to follow the five-step OECD framework. These steps require an importer to:

a) Establish strong company management systems;
b) Identify and assess risk in the supply chain;
c) Design and implement a strategy to respond to identified risks;
d) Carry out an independent third-party audit of supply chain due diligence; and
e) Report annually on supply chain due diligence.

The Regulation applies directly to between 600 and 1,000 EU importers. The European Commission has decided to apply thresholds to import volumes, set out in Annex I of the Regulation, to avoid excessive compliance burden on SMEs. According to Article 1, Section 3, all volume thresholds are set at a level that ensures that the vast majority, but no less than 95%, of the total volumes imported into the Union of each mineral and metal under the Combined Nomenclature code is subject to the obligations of Union importers set out in this Regulation.

Union importers retain individual responsibility to comply with the due diligence obligations set out in the EU Conflict Minerals Regulation, and Member States competent authorities are responsible for ensuring the uniform compliance of Union importers of 3TG by carrying out appropriate ex-post checks. According to Article 16 of the Regulation, Member States lay down the rules applicable to infringement, and implementation of the Regulation at the level of EU Member States varies widely. For example, in Luxembourg the maximum fine is 100,000 Euro, while in Austria the maximum is set at 726 Euro.[61] The European Commission will conduct the first review on the functioning and effectiveness of the Regulation by 1 January 2023, and every three years thereafter.

60 *Organisation for Economic Co-operation and Development*, OECD Due Diligence Guidance for Responsible Supply Chains of Minerals from Conflict-Affected and High-Risk Areas, Third Edition, Paris, 2016, available at: https://doi.org/10.1787/9789264252479-en (14/3/2022).

61 *European NGO Coalition on Conflict Minerals*, The EU Conflict Minerals Regulation: Implementation at the EU Member State Level, 2021, available at: https://germanwatch.org/sites/default/files/Review%20of%20member%20state%20RU%20policy%20regulacion%20on%20responsible%20sourcing.pdf (14/3/2022), p. 12.

2. WTO compatibility

The Regulation puts importers of the four minerals on a different par. When the import comes from a conflict-affected or high-risk area (CAHR area), the importer needs to exercise due diligence. If that is not the case, the import is allowed without such requirements. However, the EU does not itself prohibit the import, but simply puts a burden on the importers. Therefore, the question of whether the DD requirements pose a WTO problem arises. In that respect, it is significant that Article 4 (f) (v) of the Regulation requires "additional information" for imports from a CAHR area, for example: mention of the mine of mineral origin; the locations where minerals are consolidated, traded and processed; and taxes, fees and royalties paid. Such a discrimination in the import formalities falls under Article I:1 GATT even if it does not distinguish between "countries", but between "areas". There is at least a *de facto* discrimination as CAHR areas will typically be connected with specific states, whose imports are then treated worse than the imports from other states.[62] Moreover, it is at least arguable that an issue under III:4 GATT arises, as the EU sets an incentive for EU operators to disengage with mineral suppliers from CAHR areas, leading to unequal treatment in the EU.[63]

As a trade measure hitting imports from CAHR areas into the EU, the conflict minerals regime hence needs a proper justification under Article XX or XXI GATT. In so far as the regime helps in combating illicit trade in the Democratic Republic of Congo, it could rely on the sanctions regime of the UN Security Council. In § 4 (g) the UN Security Council Resolution 1857 (2008), it sanctioned "individuals or entities supporting the illegal armed groups in the eastern part of the Democratic Republic of the Congo through illicit trade of natural resources". Under §§ 7-8 of Resolution 1952 (2010), equally adopted under Chapter VII of the UN Charter, the Security Council then calls upon all States "to take appropriate steps to raise awareness of due diligence guidelines and to urge importers, processors and consumers of mineral products of Congolese minerals to exercise due diligence". That language creates an international obligation for UN Member States and is hence relevant for a justification under Article XXI (c) GATT for the EU.

However, as the EU's CAHR concept may also apply to imports from other countries than the DRC, the WTO coverage is less obvious for such imports. Moreover, it is hard to rely on the security exception when minerals are targeted from a "high-risk area" for weak government structure or a bad human rights record. For that scenario, the EU could rely on Article XX (a) GATT instead, arguing that European public morals also include the protection of basic human rights in other countries. As shown above in the EC-Seals case, the AB has in principle accepted the reliance on animal welfare considerations outside the EU's territorial jurisdiction. It could then equally accept the idea of extraterritorial human rights protection. Moreover, the exception on prison labour under Article XX (e) GATT already

62 *Partiti/van der Velde*, ASSER research paper 2017/2, pp. 7–8.
63 Ibid., pp. 15–17.

shows that WTO members are entitled to restrict trade when the goods are affected by certain unacceptable practices in the exporting country. Finally, given that the Conflicts Minerals Regulations follows guidance from the OECD, it would also be possible to argue that the measures are "necessary" within the meaning of Article XX(a) GATT, as there are no equally effective, but less trade restrictive measures reasonably available. In a similar vein, such rooting in an international framework makes it plausible that it is applied *bona fide*, i.e. respecting the requirements of the *chapeau* of Article XX GATT.[64]

III. The Bangladesh Compact

1. EU background

Another important initiative of the then Trade Commissioner De Gucht was the initiation of the "Bangladesh Compact" in 2013. After a tragic event in Rana Plaza, where the building of a garment factory collapsed and killed over 1,100 workers, the EU engaged with the government of Bangladesh and the ILO to discuss the improvement of working conditions in the Bangladeshi textile sector. While not officially put on the table, the understanding was that absent such engagement, the EU would be prepared to withdraw GSP concessions from Bangladesh. As a result thereof, the three partners signed a Joint Statement on 8 July 2013, entitled the "Sustainability Compact for continuous improvements in labour rights and factory safety in the Ready-Made Garment and Knitwear Industry in Bangladesh" (in short: the Bangladesh Compact).[65] The main points were a promise of the government to amend the safety laws in the country in consultation with the ILO and to increase monitoring activities by strengthening the national labour inspection offices. Under Article 3 b) of the Joint Declaration, the governments also welcomed the commitments of over 70 (mainly US American) textile companies to improve the fire and safety standards in their factories, reflected in the 15 May 2013 "Accord on Fire and Building Safety in Bangladesh".[66] That text had been negotiated between the participating companies and two international trade unions.[67] Interestingly, it also contained an arbitration clause, opening the jurisdiction of the Permanent Court of Arbitration in the Hague under UNCITRAL rules. Two cases brought by an international confederation of workers in 2016 were settled on this basis in 2018.[68]

64 Ibid., pp. 20–21.

65 See the Joint Statement, Staying engaged: A Sustainability Compact for continuous improvements in labour rights and factory safety in the Ready-Made Garment and Knitwear Industry in Bangladesh, available at: https://trade.ec.europa.eu/doclib/docs/2013/july/tradoc_151601.pdf (14/3/2022).

66 See the Accord on Fire and Building Safety in Bangladesh, available at: https://bangladesh.wpengine.com/wp-content/uploads/2018/08/2013-Accord.pdf (14/3/2022).

67 https://bangladeshaccord.org/ (14/3/2022).

68 See PCA Case 2016-36, available at: https://pcacases.com/web/sendAttach/2438 (14/3/2022) and PCA Case 2016-37, available at: https://pcacases.com/web/sendAttach/2439 (14/3/2022). See the Termination Orders of the PCA of 17/7/2018.

It can be assumed that the friendly settlement further contributed to the effectiveness of the Accord in bringing about better labour conditions in the Bangladeshi textiles industry.

Under the tripartite Bangladesh Compact between the EU, Bangladesh and the ILO, the government committed to bringing the Bangladesh Labour Act (BLA) in line with international labour standards, particularly regarding certain aspects of freedom of association and collective bargaining. Amendments to the BLA have resulted in the registration of more than 500 Ready-Made Garment (RMG) unions.[69] The Department of Inspection of Factories and Establishments (DIFE) has undergone significant upgrade, increasing its capacity in terms of personnel, budget and skills to carry out its mandate. In January 2014, the Office of the Chief Inspector of Factories and Establishments was upgraded to a full Department. DIFE was authorised to hire more than 500 inspector positions. From June 2013 to March 2018, the number of inspectors jumped from 92 to 312.[70]

2. WTO compatibility

Clearly, the Bangladesh compact of July 2013 between the EU, the ILO and Bangladesh does not raise a WTO issue as such. However, it had been linked with a possible repeal of generalized preferences for Bangladesh by the EU, and the question of whether such action would have been possible under WTO law becomes relevant. In this respect, it should be recalled that the granting of better market access to developing countries is a unilateral EU concession, which has its roots in the 1979 enabling clause. This WTO waiver decision allows a departure from Article I:1 GATT when a concession is rooted in a "generalized" system of preferences. That is the case for the EU's GSP regulation 978/2012.[71] At the same time, the EU also operates even lower tariffs for developing countries which comply with certain human rights and labour standards ("GSP plus" regime under Articles 9–16 of the regulation). Under that regulation is also possible to temporarily withdraw such an additional concession for one or several products, if a third country government does not respect its commitments (Article 15). Accordingly, the reduction of a trade preference from a "GSP plus" status to a "standard GSP" status would not have raised an issue under WTO law, as it would not have involved a departure from a bound MFN tariff under Article II GATT vis-à-vis Bangladesh.

69 *European Commission*, Implementation of the Bangladesh Compact – Technical Status Report, September 2018, available at: https://trade.ec.europa.eu/doclib/docs/2018/september/tradoc_157426.pdf (14/3/2022), p. 7.
70 Ibid., pp. 19–20.
71 OJ L 303 of 31/10/2012, p. 1.

IV. The EU Deforestation Regulation

1. EU background

In the EU Communication on stepping up EU action to protect and restore the world's forests of July 2019,[72] the Commission sets five priorities to protect existing forests and address deforestation and forest degradation. This commitment was later confirmed in the European Green Deal,[73] the 2030 EU Biodiversity Strategy[74] and the Farm to Fork Strategy.[75] The European Parliament called on the Commission "to present, without delay, a proposal for a European legal framework based on due diligence to ensure sustainable and deforestation-free supply chains for products placed on the EU market".[76] In October 2020, the Parliament adopted a legislative-initiative report with recommendations to the Commission on an EU legal framework to halt and reverse EU-driven global deforestation. The report called for "an EU legal framework based on *mandatory* due diligence, reporting, disclosure and third party participation requirements, as well as liability and penalties in case of breaches of obligations for all companies placing for the first time on the Union market commodities entailing forest and ecosystem risks and products derived from these commodities".[77] Next to the due diligence approach advocated by the Parliament, the Commission considered several policy options, including mandatory labelling, voluntary commitments and labelling, and verification schemes and methods.

A legislative proposal was published on 17 November 2021.[78] The chosen approach consists of a mandatory due diligence system combined with benchmarking. Countries will be categorised under low, medium or high risk, based on their en-

72 Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions, Stepping up EU Action to Protect and Restore the World's Forests, COM/2019/352 final.

73 Communication from the Commission to the European Parliament, the Council, the European, Economic and Social Committee and the Committee of the Regions, The European Green Deal, COM/2019/640 final.

74 Communication from the Commission to the European Parliament, the Council, the European, Economic and Social Committee and the Committee of the Regions, EU Biodiversity Strategy for 2030 Bringing nature back into our lives, COM/2020/380 final.

75 Communication from the Commission to the European Parliament, the Council, the European, Economic and Social Committee and the Committee of the Regions, A Farm to Fork Strategy for a fair, healthy and environmentally-friendly food system, COM/2020/381 final.

76 European Parliament Resolution of 15/1/2020, available at: https://www.europarl.europa.eu/doceo/document/TA-9-2020-0005_EN.html (14/3/2022), § 71.

77 Motion for a European Parliament Resolution with recommendations to the Commission on an EU legal framework to halt and reverse EU-driven global deforestation, available at: https://www.europarl.europa.eu/doceo/document/A-9-2020-0179_EN.html (14/3/2022), § 24.

78 *European Commission*, Proposal for a Regulation of the European Parliament and of the Council on the making available on the Union market as well as export from the Union of certain commodities and products associated with deforestation and forest degradation and repealing Regulation (EU) No 995/2010, COM/2021/706 final.

gagement in fighting deforestation and forest degradation. Due diligence duties will vary according to the level of risk the country of production represents.[79] The products under scrutiny are beef, palm oil, soy beans, wood, cocoa, coffee and related products (i.e. those that contain, have been fed with or have been made using relevant commodities).[80] Under Article 3, relevant commodities and products may enter the EU market or be exported from the Union market if they fulfil the following conditions:

1. They are deforestation-free as defined in Article 2(8) of the proposal;[81]
2. They have been produced in accordance with the relevant legislation of the country of production; and
3. They are covered by a due diligence statement.

According to Article 4(2), the DD statement shall confirm that due diligence was carried out and no or only negligible risk was found. Due diligence shall include information relating to the relevant commodities or products, risk assessment measures and risk mitigation (Article 8(2)). Based on Article 23(1), it is up to Member States to lay down rules on penalties applicable to infringements of the provisions of the Regulation. Therefore, paragraph 2 provides the list of penalties to be established in national legal systems. Penalties shall include fines, confiscation of the relevant commodities and products as well as confiscation of revenues, and temporary exclusion from public procurement processes. Fines should be proportionate to the environmental damage and the value of the relevant commodities. The maximum amount of such fines shall be at least 4% of the operators or traders' annual turnover.

2. WTO compatibility

As the deforestation regime may undergo considerable changes before enacted as a regulation, it is premature to engage into a deep analysis of the Commission proposal's WTO compatibility. Depending on the covered products and the possible definitions of "deforestation-free", different countries may be impacted to different degrees. If some *de facto* discrimination were to occur between importing countries in a similar situation contrary to Article I:1 GATT, reliance on objective criteria will be an important factor in justifying the scheme under Article XX(g) GATT and its *chapeau*.

79 Ibid., pp. 8–9.
80 Ibid., p. 11.
81 Ibid., p. 35. The definition reads:
(8) 'deforestation-free' means
(a) that the relevant commodities and products, including those used for or contained in relevant products, were produced on land that has not been subject to deforestation after December 31, 2020, and
(b) that the wood has been harvested from the forest without inducing forest degradation after December 31, 2020.

V. The EU General Due Diligence Scheme

1. EU background

Next to these sectoral (tropical timber, conflict minerals, deforestation) and country-specific (Bangladesh) initiatives, the EU is also working on a general due diligence scheme. The motivation may be three-fold. First, horizontal regimes have already been adopted in France[82] and Germany,[83] and other Member States such as Belgium, the Netherlands, Luxemburg and Sweden are contemplating a similar step.[84] That may create different obligations on EU companies and potentially distort competition, which should be avoided in the EU's internal market. Second, EU Member States, which are also members of the OECD, were active in the preparation of the 1976 OECD guidelines. When the UN Guiding Principles on Business and Human Rights were adopted by the Human Rights Council in 2011, the OECD Guidelines were brought in line with the UN standards.[85] Nowadays, the EU itself participates in the negotiations of a binding instrument on "Transnational Corporations and Other Business Enterprises with respect to human rights", set up in 2014 by the UN Human Rights Council. This increasing international dimension of supply chain responsibility also triggered an increased attention to the domestic regulation of the matter within the EU legal order. Third, there is a growing awareness that "soft law" approaches met certain limits in their effectiveness. Hence, giving the increasing need to protect human rights and environmental standards by "hard law", the Commission is taking the view that legislation is necessary.

In 2019, the European Fundamental Rights Agency released a report on "business-related human rights abuse reported in the EU and available remedies".[86] Most of the incidents reported in the 30 participating States in the survey related to environmental issues or fair working conditions.[87] On 29 April 2020, European Commissioner for Justice Didier Reynders announced that the Commission had started consultations on a possible legislative initiative aimed at integrating human rights and environmental due diligence into corporate strategies, as part of a Sustainable Corporate Governance (SCG) initiative. Accordingly, the Commission Work Programme for 2021 announced a proposal for a directive on sustainable corporate governance that would cover human rights and environmental due diligence.

82 Loi du 27 mars 2017 relative au devoir de vigilance des sociétés mères et des entreprises donneuses d'ordres.
83 Lieferkettensorgfaltspflichtengesetz vom 11. Juni 2021.
84 For an overview see *Business & Human Rights Resource Centre*, National and Regional Movements for Mandatory Human rights and Environmental Due Diligence in Europe, available at: http://www.business-humanrights.org (14/3/2022).
85 For a discussion see *Bonnitcha/McCorquodale*, EJIL 2017/3, p. 899.
86 *European Union Agency for Fundamental Rights*, Business-related human rights abuse reported in the EU and available remedies, 2019, available at: https://fra.europa.eu/sites/default/files/fra_uploads/fra-2019-business-and-human-rights-focus_en.pdf (14/3/2022).
87 Ibid., p. 8.

The inception impact assessment on Sustainable Corporate Governance of 30 July 2020 gave some indications on the main objectives. The initiative aimed to ensure that sustainability is embedded into corporate governance frameworks and that these frameworks incentivise corporate boards to integrate stakeholder interests and sustainability assessments into corporate decisions. The initiative builds on existing work in the framework of sustainable finance, in particular on two studies delivered to the Commission in 2020. The first study "on due diligence requirements through the supply chain" focused on due diligence requirements to identify, prevent, mitigate and account for abuses of human rights. It analysed possible regulatory intervention options at the EU level.[88] The second "Study on directors' duties and sustainable corporate governance" focused on issues of "short-termism" in corporate governance and company law, covering directors' duties, board remuneration, business sustainability, and stakeholder involvement.[89]

On 26 October 2020, the European Commission launched a public consultation on the proposal of its Sustainable Corporate Governance initiative, which was concluded on 8 February 2021. The consultation collected the views of stakeholders on the needs and objectives for EU intervention concerning a possible initiative on sustainable corporate governance, and gathered data on how to better assess the costs and benefits of different policy options, helping shape the future European Commission proposal. Almost half a million public responses were obtained during the consultation period, driven to a large extent by campaigns carried out by NGOs. When adopting its new trade strategy in February 2021, the European Commission confirmed that the proposal on sustainable corporate governance would include *mandatory* environmental, human and labour rights due diligence obligations.[90]

The European Parliament has also been pushing for increased corporate accountability and more sustainable supply chains as a general policy. In its legislative own initiative resolution of 10 March 2021, it called for the urgent adoption of binding requirements that ensure companies are held accountable and liable when they harm human rights, the environment and good governance. Any future Directive should aim "to ensure that undertakings can be held accountable and liable in accordance with national law for the adverse impacts on human rights, the environment and good governance that they cause or to which they contribute in their value chain, and aims to ensure that victims have access to legal remedies".[91]

88 *European Commission*, Directorate-General for Justice and Consumers, Study on due diligence requirements through the supply chain: final report, Publications Office, 2020, available at: https://data.europa.eu/doi/10.2838/39830 (14/3/2022).

89 *European Commission*, Directorate-General for Justice and Consumers, Study on directors' duties and sustainable corporate governance: final report, Publications Office, 2020, available at: https://data.europa.eu/doi/10.2838/472901 (14/3/2022).

90 European Commission Communication, Trade Policy Review – An Open, Sustainable and Assertive Trade, COM (2021) 66 final, available at: https://trade.ec.europa.eu/doclib/docs/2021/february/tradoc_159438.pdf (14/3/2022), p. 14.

91 European Parliament Resolution of 10/3/2021, available at: https://www.europarl.europa.eu/doceo/document/TA-9-2021-0073_EN.pdf (14/3/2022), Article 1(3) of the Draft Directive.

On 25 February 2022, the Commission adopted the long-awaited proposal for a Directive on Corporate Sustainability Due Diligence.[92] Based on Articles 50 and 114 TFEU, the Commission wishes to regulate "sustainability due diligence obligations of companies and at the same time covers – to the extent linked to that due diligence corporate directors' duties and corporate management systems to implement due diligence".[93] The proposal would apply immediately to large companies (150 Mio. EUR turnover with more than 500 employees) and after a two-year transition period also to companies with 40 Mio. EUR turnover and 250 employees in certain high-risk sectors (Articles 2(1) and (2) of the Draft Directive).

On substance, the Directive requires from covered companies to follow the six steps from the OECD General Framework for Responsible Business. Under Article 4(1) of the Draft Directive they encompass:

(1) Integrating due diligence into policies and management systems;
(2) Identifying and assessing adverse human rights and environmental impacts;
(3) Preventing, ceasing or minimizing actual and potential adverse human rights, and environmental impacts;
(4) Assessing the effectiveness of measures;
(5) Communicating;
(6) Providing remediation.

From a legal perspective, the key issue in this list is the third obligation: How far is a company required to prevent, cease or minimize actual and potential *adverse human rights effects and environmental impacts*? In this respect, Articles 7 and 8 require that companies prevent such adverse effects and bring them to an end. Recital 15 contains the important clarification that companies are not expected to guarantee the full compliance with the human rights and environmental norms at stake, when the violation is outside their sphere of influence. Rather, they have an "obligation of means" to the appropriate measures which can reasonably be expected from them. Further criteria on assessing what "appropriate measures" should be are laid down in Articles 7(2)–(6), 8(3)–(7) and further explained in Recital 29.

Closely connected with the previous question is the issue of scope: which human rights and environmental standards form part of the due diligence exercise? In that respect, the Commission opted for a "list of rights" approach, derived from relevant international human rights conventions. At the same time, it also made sure that the non-listed rights are not simply "forgotten". Owing to the need to promote the "indivisibility of human rights", as explicitly required by Article 21(1) TFEU, a non-listed right may also be relevant for the due diligence exercise if there is a likely pertinence of such non-listed right for the operations of the company (see Annex, Part I, Point 21). Recital No. 25 explains this important addition as follows:

92 Commission proposal for a Directive on Corporate Sustainability Due Diligence, COM (2022) 71 final of 23/2/2022.
93 Ibid., Explanatory Memorandum, p. 10.

> (25) In order to achieve a meaningful contribution to the sustainability transition, due diligence under this Directive should be carried out with respect to adverse human rights impact on protected persons resulting from the violation of one of the rights and prohibitions as enshrined in the international conventions as listed in the Annex to this Directive. In order to ensure a comprehensive coverage of human rights, *a violation of a prohibition or right not specifically listed in that Annex which directly impairs a legal interest protected in those conventions should also form part of the adverse human rights impact covered by this Directive, provided that the company concerned could have reasonably established the risk of such impairment and any appropriate measures to be taken in order to comply with the due diligence obligations under this Directive, taking into account all relevant circumstances of their operations, such as the sector and operational context.* Due diligence should further encompass adverse environmental impacts resulting from the violation of one of the prohibitions and obligations pursuant to the international environmental conventions listed in the Annex to this Directive.

Turning to environmental standards, the relevant guidance is provided in Draft Articles 15 and Part II of the Annex, mentioning twelve specific duties flowing from relevant international conventions for the protection of the environment. Company business plans should integrate the Paris Climate objectives and the due diligence obligations in Articles 7 and 8 also apply to prevent, mitigated and terminate adverse environmental impacts.

An important difference to the previous regimes on tropical timber and conflict minerals lies in the area of sanctions for non-compliance. Beyond the classical method of requiring from the Member States to enact effective (administrative) sanctions, the Commission proposes to introduce the concept of civil liability in Draft Article 22 for violations of the obligations laid down in Articles 7 and 8. Without any doubt this "sharp sword" will be a focus of the subsequent discussions with the Parliament and the Council.

2. WTO compatibility

Like with the deforestation proposal, it too early to take a view on the WTO compatibility of the new general scheme. One issue of concern could be compliance with the national treatment of Article III:4 GATT as the coverage criteria for domestic and foreign companies are not identical. EU companies are only covered when their total turnover is over 150 Mio. € and they employ over 500 employees or when they exceed a turnover of 40 Mio. € with over 250 employees in certain risk sectors (Articles 2(1) of the Draft Directive). In turn, a foreign company which generate a turnover in Europe of 150 € is covered even if the number of employees is lower (Article 2 (2) of the Draft Directive). At first sight, the non-application of the employee threshold could hence be regarded as a discrimination of foreign companies.

However, a closer look reveals that this difference can be justified by objective reasons. First, the turnover threshold for the foreign company is lower than the one operated for EU companies, as it only looks at turnover generated in Europe to create the territorial nexus.[94] Second, the difference is designed in a way as to avoid *de facto* discrimination. The Commission observed:

> While the Directive will cover about 13 000 EU companies, based on the estimations of the Commission, it will only cover about 4 000 third-country companies. The fact that EU companies will only be covered if they also reach the minimum limit on the number of employees is very unlikely to change the conditions of competition in the EU internal market: the two size criteria applicable to EU companies, even if cumulative, will result in still covering relatively smaller companies compared to non-EU companies due to the fact that, in their case, the entire worldwide net turnover of the company is to be taken.[95]

F. Conclusion

In conclusion, it is submitted there are four main regulatory approaches in the European Union towards supply chain responsibilities:

- Specific import regimes;
- Marketing prohibitions;
- Mandatory reporting regimes;
- Due diligence regimes.

Import regimes prohibit the import of the product concerned, unless certified by the exporting government. The best example is the Kimberley Process Certification Scheme. The EU trade regime against illegal, unreported or unregulated fishing follows a similar logic. As it is embedded in a broader effort to bring about cooperation by unwilling third states, it does, however, go beyond a pure trade tool.

General marketing prohibitions start from a similar, but somehow different logic. Here, the EU does not implement an internationally agreed system, but wishes to enforce its own values in the internal market, which may not be shared by other nations. The EU bans on cat and dog fur and seal products respond to a widely held belief on animal welfare, and are accompanied by relevant import bans. A marketing prohibition for goods made by forced labour would also fall into this category.

In the first two categories, the public authorities are crucial to control the supply chain. It is usually the customs and domestic control authorities, which will enforce the import and marketing bans.

The situation becomes more complicated when we turn to the third and fourth regulatory approaches, namely the transparency and due diligence regimes. In those schemes, the EU creates certain transparency and risk assessment obligations for

94 Commission proposal for a Directive on Corporate Sustainability Due Diligence, COM (2022) 71 final of 23/2/2022Ibid., Recital 24 of the Draft Directive, p. 34.
95 CIbid., Explanatory Memorandum, p. 16.

private companies. In the "soft" instrument of reporting obligations, the "sanction" is bad publicity for a particular enterprise. The instruments become stronger when the companies have to fulfil due diligence requirements to be able to import and market the product concerned. While the EU Tropical Timber Regulation was the "only kid on the block" for a long time, we currently witness a big shift. The EU Conflict Minerals Regulation has entered into force, and the Commission adopted in November 2021 an ambitious proposal to combat deforestation. Another Commission proposal on human rights and environmental diligence from February 2022 even contains the idea of civil liability.

All four regulatory approaches demonstrate that the EU is taking steps in increasing its commitment to fairer and more transparent supply chains, thereby responding to the primary law objectives laid down in Articles 3(5) and 21(2) TEU. Sometimes, the initiatives can more be rooted in foreign policy objectives under Article 21(2)(c) TEU, but most of the times they are clearly linked to the goal laid down in Article 21(2)(f) TEU to foster the sustainable management of international resources. The new proposal on general supply chain responsibility also has a strong human right component, responding to the foreign policy goal under Article 21(2)(b) TEU.

At the same time, the EU is careful not to overstep the boundaries of WTO law. It is submitted that the security exception under Article XXI GATT provides a sufficient justification for the Kimberley-process and parts of the Conflicts Minerals Regulation, insofar as imports from the Democratic Republic of Congo are concerned. Article XX(a) on public morals was relevant in the EC-Seals Cases, and would probably be relied on to justify restrictions to foster animal welfare (cats and dogs fur regulation), to fight human rights violations (conflict minerals regulation) or forced labour (future marketing prohibition). In addition, Article XX(g) plays a big role in justifying the IUU fisheries regulation and may be relevant for the tropical timber and deforestation due diligence regimes as well. Finally, the *chapeau* of Article XX GATT needs to be observed to make sure that any regime is applied bona fide to all countries in similar situations. In the EC-seals case, the EU has shown its willingness to adapt its internal regime to a finding of the Appellate Body, and the design of the due-diligence regimes will have to keep in mind the obligation to not discriminate between major importing countries in the design of such schemes.

Notwithstanding their legality under European and international law, the effectiveness of the EU regulatory regimes will rely mostly on implementation by the companies and enforcement by the competent authorities of Member States. The fully harmonized Kimberley process has been in place since 2003, and it has proven effective in curtailing trade in conflict diamonds. The IUU regulation is also a sharp sword, as it potentially closes the entire EU market for a third country receiving a red card. *En revanche*, the due diligence regimes may have a self-disciplining effect among businesses, but are generally less effective so far against potential "offenders". A too wide divergence in the administrative enforcement powers may be detrimental to the proper functioning of these schemes as the case of the EU tropical

timber regulation shows. Moreover, the question will come up as to whether the "piling up" of special due diligence obligations for certain products and a general scheme for human rights, labour and environmental reasons, may not lead to new legal uncertainties for EU operators. Lastly, the relationship with national schemes will have to be revisited.

There is hence a lot of room for further research in this evolving field of EU external relations law when the Institute will celebrate its 75th anniversary in five year's time!

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