Ethical Trading Initiative

The new European Directive on Corporate Sustainability Due Diligence, ETI recommendations

On 23 February 2022, the European Commission adopted a proposal for a Directive on Corporate Sustainability Due Diligence. The proposal aims to foster sustainable and responsible corporate behaviour throughout global value chains.[i]

The Ethical Trading Initiative (ETI) is a leading alliance of companies, trade unions and NGOs that promotes respect for workers' rights around the globe. Our membership includes several of the EU's largest companies in the apparel and food retail industries, and other industries such as cosmetics. The recommendations below are based on 25 years of experience working with our global membership and 11 years in practical implementation of the obligations set out in the UN Guiding Principles on Business and Human Rights (UNGPs), focusing on the rights set out in the ETI Base Code through a process of continuous improvement and shared learning.

KEY RECOMMENDATIONS

i. **Clearly state** in Articles 7(1) and 8(1) that the **duty to exercise human rights due diligence is an ongoing standard** of expected conduct which should take place **in line with the UNGPs and OECD Guidelines**, and that the actions set out elsewhere in the Directive are ways of showing that this duty has been met but do not constitute a closed or exhaustive list of steps that need to be taken.

   In addition, lay out **criteria for best practice among contractual assurances and third-party verification**.

ii. Remove references to 'where relevant' in Article 6(4) and in Article 8(3)(b) and more **expressly require effective engagement with rights holders** or those who represent rights holders, including trade unions in Articles 6, 7, 8, 9, 10 and 11, including as part of the ongoing duty of human rights and environmental due diligence.

   Explicitly mention the need for **specific consideration for people, including children, in situations of heightened vulnerability**.

iii. Amend Articles 7 and 8 to **oblige companies to undertake root cause analysis that includes, where applicable, business models, practices, and strategies**, including trading, procurement, and pricing practices as part of the due diligence obligation.

   Explicitly mention the importance of Living Wages as a key enabler of human and environmental rights.

iv. **Clarify expectations of companies** by replacing the word 'appropriate' with 'necessary' in Article 8(1) and modifying the text to read 'Where the adverse impact cannot be brought to an end, Member States shall ensure that companies minimise the impact to the greatest extent possible' in Article 8(2).

   Remove requirements to suspend or terminate business relationships in Articles 7(5) and 8(6). **Make it clear that before deciding to suspend or terminate a relationship companies should first exercise the due diligence** required of them, and exhaust the possibilities of these measures to prevent, cease or mitigate adverse impacts. **Expressly state that the decision to either stay in the relationship or to suspend or terminate the relationship, as well as the actions thereafter (such as implementation of responsible exit strategies), will be subject to the legal test of whether companies have undertaken appropriate due diligence.**

**For human rights,
for better business**

v. **Expand the scope of company inclusion to include small and medium organisations,** based on the principles of proportionality, in line with the European Parliament's own initiative report.

vi. **Remove the limitation of the legal duty only to 'established relationships'.** Align with the UNGPs by demanding **due diligence across the full scope of the supply chain** but allow for **prioritisation based on severity and likelihood of risk and impact.**

vii. **Specify a non-exhaustive number of high-risk factors**, in addition to sectors, that companies need to take into consideration, such as significant volumes of migrant labour, seasonal labour, informal labour such as home-based labour, poverty, gender imbalance, conflict affected areas or ecological disasters. **Periodically review the list of high-risk sectors** and factors as new information and data comes to light.

viii. **Remove the exemption that 'large' companies within the named high-risk sectors must conduct due diligence on 'severe impact only'**. Align with the UNGPs by demanding **companies address all risks but** allow for **prioritisation based on severity and likelihood of risk and impact.**

ix. **Remove all exemptions on the financial sectors' due diligence obligations** from Articles 6(3), 7(6) and 8(7).

x. In Article 9, **explicitly mention the criteria** set out in Guiding Principle 31 of the UNGPs **to ensure the effectiveness of non-judicial grievance mechanisms.**

xi. In Article 22(2), **remove the function of contractual assurances, industry initiatives, and third-party verification to validate the appropriate implementation of due diligence.** In Article 22, specify that the burden falls to the **company to prove that it could not have done more to avoid the causation of harm,** once the victim has proven the damage inflicted and the connection to the business activities of the company.

xii. **Require companies to continually disclose key information relevant to human rights due diligence processes**, such as governance and accountability structures, supply chain geography and risk, respect for trade union rights including respect for freedom of association and collective bargaining, and actions taken to mitigate risk or remediate harm.

xiii. The Commission should put in place mechanisms to **ensure minimum standards and harmonisation** in how the Directive is adopted, implemented, and enforced across the EU's 27 member states.

ETI welcomes the EU taking a leading role in promoting human rights due diligence within the wider sustainability directive and recognises the complexity of developing such a wide-reaching piece of legislation, that has the potential to influence actors across the globe.

Within ETI's membership is a wealth of best practice that demonstrates the ability of businesses to undertake robust and effective human rights due diligence, regardless of size and across multiple supply chains. We would like to see best practice set the bar for legislation, incentivising all companies to embed human rights due diligence into the core of their business practices. ETI supports the Directive's aims to create more legal certainty and a level playing field for companies, whilst also providing added transparency for consumers and investors alike.[ii] We believe that this is in the interests of business, increasing visibility of risk, supporting effective action and meeting consumer expectations as proved by leading firms who actively apply human rights due diligence. The ETI's approach to doing business responsibly in complex global supply chains is closely based on the UNGPs, which set out the Protect, Respect and Remedy framework. States should protect human rights; businesses should respect those rights; and both should work to provide remedy when rights are violated. We provided input into the development of the OECD sector guidelines which provide practical guidance and note that this helps business understand and apply the standards developed in international norms, such as ILO and UN conventions. ETI's approach to human rights due diligence, as set out in our Human

Rights Due Diligence Framework, is based on multi-stakeholder engagement and processes that include assessing risks, identifying leverage, acting to mitigate risks, and monitoring success. ETI's experience has demonstrated that this is the most effective form of due diligence and the most likely way to bring about lasting change.[iii]

To achieve its ambitions, due diligence legislation needs to be carefully designed:

1. It should encourage stakeholders to work collaboratively to identify, prevent and mitigate root causes of human rights violations, including lead firms' own business models and practices, whilst avoiding a system in which responsibility and blame are passed down the supply chain.
2. It should set clear expectations, that are realistic and actionable, and help to clarify the respective roles and responsibilities of the state and of business.
3. It should include sufficient enforcement mechanisms to ensure that non-compliant businesses can be held accountable and establish clear, transparent systems that enable workers to access effective remedy.

ETI's recommendations are focused on the Directive achieving these 3 principles.

1. Encourage stakeholders to work collaboratively to identify, prevent and mitigate root causes

In its current form, the Directive risks incentivising an ineffective over-reliance on contractual assurances and third-party verification rather than encouraging businesses to consult with experts in the field, work with multi-stakeholder engagement and engage rights-holders to uncover, prevent and mitigate the root causes of human rights violations.

i. Due diligence not compliance

The Directive refers to contractual assurances and third-party verification in the description of due diligence duty. Whilst these methods can be useful tools for companies to exercise leverage or to use as part of a broader risk assessment, it is important to recognise their significant limitations. Audits represent a snapshot of a given point in time. They give companies a one-dimensional view, when human rights risks are, by their very nature, complex and not likely to be revealed willingly.[iv] ETI's experience demonstrates third-party verification through social auditing is insufficient in detecting many forms of human rights violations. For example, it does not pick up cases of modern slavery or forced labour because these are hidden crimes, and victims do not feel safe enough to report, even if asked about their working conditions.[v] Similarly, children working illicitly in supply chains, or affected by business activity are most often invisible to such systems.[vi] Crucially, the 'tick-in-the-box' approach of many social audits does not describe why violations occur, nor does it include the lead firm's actions for the consideration of root causes.

As per the UNGPs, human rights due diligence applies to all firms in a value chain. It demands collaboration in a pro-active investigation and understanding of risk and potential impacts and involves the full due diligence cycle: assessing risks, identifying leverage, acting to mitigate risks, and monitoring success. In contrast, an over-reliance on compliance mechanisms creates a pass-fail approach that places pressure down the supply chain and can drive obfuscation and lack of transparency about identifying human rights risks. A study conducted by the European Centre for Constitutional and Human Rights (ECCHR), in collaboration with Misereor and 'Bread for the World', examines four exemplary cases from different sectors and illustrates how, absent more meaningful human rights due diligence, some audit and certification schemes can even increase human rights risks.[vii] The Directive should lay out criteria for best practice among contractual assurances and third-party verification in recognition that the content and quality of these methods will determine their effectiveness as part of a due diligence system. It must be clear that these are tools with specific and limited functions and do not in themselves constitute due diligence.

The Directive also mentions '*suitable industry initiatives*'. Whilst these can be a valuable way to add leverage and aggregate corporate actions, participation in itself does not absolve the individual business of ensuring the action taken is relevant and effective. As per the UNGPs, the '*responsibility to respect*' relates to the business. The Directive must be clear that the use of contractual assurances, suitable industry initiatives and independent third-party verification does not in itself absolve the business of its human rights due diligence responsibility.

Recommendation: Clearly state in Articles 7(1) and 8(1) that the **duty to exercise human rights due diligence is an ongoing standard** of expected conduct which should take place **in line with the UNGPs and OECD Guidelines**, and that the actions set out elsewhere in the Directive are ways of showing that this duty has been met but do not constitute a closed or exhaustive list of steps that need to be taken.

In addition, lay out **criteria for best practice among contractual assurances and third-party verification**.

ii. Effective engagement with rights holders

An important limitation of the provisions on human rights due diligence in the Draft Directive relates to the limited role of stakeholder engagement which is only encouraged '*where relevant*', leaving all discretion to the company rather than workers or trade unions. Even then, it is only specified with relation to certain activities, such as gathering information on actual or potential adverse impacts and is absent from critical activities such as the provision of remedy. This contrasts with the UNGPs in which stakeholder engagement plays a crucial role.

In ETI's experience working closely with companies, it is not possible to develop a meaningful understanding of rights holders' experience, their expectations and therefore effective action by business, absent meaningful engagement with the rights holders themselves or their legitimate representatives. This engagement is relevant throughout the due diligence cycle, as well as in addressing any adverse human rights impacts. Those companies who do openly consult with workers and their representatives have a much more effective business response than those who don't.

The experience of the French Duty of Vigilance Law has shown the limitation of not requiring stakeholder consultation, since the lack of consultation with external stakeholders has been identified as one of the main pitfalls of the implementation of the law.[viii] In this respect, the approach of the Draft Directive of the European Parliament which contained a dedicated article on stakeholder engagement, requiring companies to carry out '*in good faith effective, meaningful and informed discussions with relevant stakeholders when establishing and implementing their due diligence strategy*', is preferred.[ix]

The Directive should more clearly recognise the importance of effective stakeholder engagement, throughout the due diligence cycle, including the specific role trade unions are able to play in this process. Specific consideration for people in situations of heightened vulnerability, such as women and girls, children, casual workers, homeworkers, indigenous communities, and smallholder farmers, should be incorporated, particularly given that these groups could be harder to access and consult with but may still be equally or even more affected by the negative impacts of businesses' operations. With regard to 'child-rights' due diligence, these were recognised back in 2013 when the Committee on the Rights of the Child asserted that States should require businesses to undertake 'child-rights due diligence', as part of upholding their obligations under the Convention on the Rights of the Child (CRC). To be more inclusive of children's rights, the Directive and the mechanisms and guidance enabling its implementation, should explicitly recognise that children in vulnerable and marginalised situations require specific attention in business' due diligence and access to remedy. Where workers are not represented by existing unions, the role of wider civil society should be mentioned.

Recommendation: Remove references to '*where relevant*' in Article 6(4) and in Article 8(3)(b) and more **expressly require effective engagement with rights holders** or those who represent rights holders, including trade unions in Articles, 6, 7, 8, 9, 10 and 11 including as part of the ongoing duty of human rights and environmental due diligence.

Explicitly mention the need for **specific consideration for people, including children, in situations of heightened vulnerability**.

iii. Business models, business practices, and purchasing practices

An integral part of due diligence is for businesses to understand their relationship to the root causes of human rights violations, and the extent to which they contribute to them through their own actions or inactions. Incentivising lead firms to take responsibility for their own role in creating working environments that create human rights risks, and to take internal corrective action, should be at the core of any due diligence legislation.

Dynamics in prevailing and many emerging business models create systemic downward pressure on workers' rights, as explored in ETI's 'Business models and labour standards: making the connection', developed in partnership with Kings College London and University of Warwick. This pressure can be compounded by problematic business and purchasing practices. A large supplier survey undertaken by ETI together with the ILO during 2015 investigated the impact of purchasing practices on human rights. In our Guide to Buying Responsibly ETI concludes '*Conventional purchasing practices, including aggressive price negotiation, inaccurate forecasting, late orders, short lead times and last-minute changes put suppliers under intense pressure and lead directly to poor working conditions and low pay for workers*.' The study found that in 2015, 39% of surveyed suppliers accepted orders worth less than the cost of production and of these: for 51%, less than 85% of the cost was covered by the price agreed; for 29%, this meant they found it harder to pay workers their due wages.[x]

The Common Framework for Responsible Purchasing Practices[xi] that has been developed for the garment sector is of significance in this respect. A reference point for companies working to improve their purchasing practices, it aims to address many of these practical issues, including equal partnership (Principle 2), fair payment terms (Principle 4), and sustainable costing (Principle 5). It highlights the importance of prices covering all costs of production in line with responsible business conduct, and companies implementing costing strategies that support increased wages to reach a living wage.

Legislation is needed to support these efforts, create the level playing field businesses are calling for and stop the 'race to the bottom'. The European Commission has recognised the need to address purchasing practices in Recital 30 of the draft Directive, which notes '*When identifying adverse impacts, companies should also identify and assess the impact of a business's relationships, business model and strategies, including trading, procurement and pricing practices*.' This language, however, is absent from the Articles.[xii] The Directive should incentivise companies to consider how their own business models and practices may carry inherent risks for workers[xiii] when undertaking root cause analysis of human rights violations.

Recommendation: Amend Articles 7 and 8 to **oblige companies to undertake root cause analysis that includes, where applicable, business models, practices, and strategies**, including trading, procurement, and pricing practices as part of the due diligence obligation.

Explicitly mention the importance of Living Wages as a key enabler of human and environmental rights.

iv. Bringing actual adverse impacts to an end, mitigating their extent and responsible exit

As per the UNGPS, where a company causes, contributes to, or is otherwise directly linked to an adverse impact, it should act and use its leverage to cease the impact, or mitigate it to the '*greatest extent possible*'. If the company lacks the leverage to do this, it should seek to increase its leverage. In the Directive, the expectation of companies is less clear. Article 8 ambiguously asks that companies take '*appropriate*' measures to bring the actual adverse impact to an end, and '*where the adverse impact cannot be brought to an end*', to simply '*minimise*' its extent. Notably, it does not state that a company should '*minimise to the greatest extent possible*' or similar injunction.[xiv]

As a last resort, the UNGPs and OECD Guidelines raise the option of suspension or termination of agreements and introduce factors for consideration such as '*whether terminating the relationship with the entity itself would have*

adverse human rights consequences'. The decision whether to end a business relationship falls on a continuum that relates to the severity of the impact, the leverage which the company has and the likelihood that the leverage will work to prevent or cease the harmful impact. The decision should itself be part of the human rights due diligence assessment.[xv]

These considerations are not reflected in the Draft Directive, which seems to have a more binary approach. It is possible that the way in which the relevant subsections in the Draft Directive are framed, they would not only disincentivise, but actually prohibit companies' from staying in the relationship and engaging. For example, where an adverse impact is severe but there is a good chance that continued leverage would improve or prevent it, a simple reading of subsection 6(b) might imply that the company would nevertheless be required to terminate the relationship. There is a likelihood that such a legal requirement on business to terminate relationships would have a counter-productive effect, lead to obfuscation and diminished transparency about risk, divestment from high-risk areas, irresponsible knee-jerk (but legally required) exits, accompanying loss of livelihoods and other harms to rights-holders and similar impacts that could have been prevented had the company been allowed to stay in the relationship and proactively engage.[xvi]

Where a decision to disengage is taken, a responsible exit plan which details the actions the company will take, as well as its expectations of its suppliers, buyers, and other business relationships to prevent adverse impacts from disengagement should be developed.

Recommendation: Clarify expectations of companies by replacing the word '*appropriate*' with '*necessary*' in Article 8(1) and modifying the text to read '*Where the adverse impact cannot be brought to an end, Member States shall ensure that companies minimise the impact to the greatest extent possible'* in Article 8(2).

Remove requirements to suspend or terminate business relationships in Articles 7(5) and 8(6). **Make it clear that before deciding to suspend or terminate a relationship companies should first exercise the due diligence** required of them, and exhaust the possibilities of these measures to prevent, cease or mitigate adverse impacts. **Expressly state that the decision to either stay in the relationship, or to suspend or terminate the relationship, as well as the actions thereafter (such as implementation of responsible exit strategies) will be subject to the legal test of whether companies have undertaken appropriate due diligence.**

2. Set clear expectations that are realistic and actionable

Counter to the UNGPs which demand due diligence across the full scope of the supply chain but allow for prioritisation based on severity and likelihood of risk and impact, the Directive significantly limits the scope of due diligence companies are expected to undertake. Whilst ETI recognises the importance of realistic, practical expectations, the current limitations risk having a counterproductive influence on business practices and failing to introduce the level playing field businesses and the European Commission itself are calling for. For the directive to achieve its aims, it must be clear that it is the risk of harm and the severity of that harm to rights holders which must be the focus of business activity in human rights due diligence.

v. Size of company included

ETI's membership includes several of the EU's largest companies (in the apparel, food, and cosmetic retail industries), as well as many small to medium sized enterprises (SMEs). Our experience proves the value and ability of SMEs to conduct human rights due diligence and act accordingly. In order to graduate to and retain full ETI membership, our corporate members must, in addition to transparency and reporting requirements, meet the entry level requirements of implementing the ETI Base Code, at a minimum, and demonstrate continuous improvement from there on. Although resource is often proportionate to the size of the company, many SMEs are dynamic and agile in adapting their business practices and can increase their leverage to create positive working environments by developing long term mutually beneficial relationships with suppliers. Our SME companies make a valuable contribution to human rights due

diligence efforts, that benefits not only the people in their own supply chains but our larger members as well, by showing creative solutions and good practice. With less resource available, many SMEs demonstrate the power of integrating due diligence into how they do business, responding to effective stakeholder engagement rather than relying on potentially costly third-party verification mechanisms.

Due diligence is about addressing risk to people. Neither a smaller company turnover nor lower number of employees removes the possibility of egregious violations within the supply chain. SMEs represent approximately 99% of all companies in the EU. If the Directive is to achieve its aims to create more legal certainty and a level playing field for companies, whilst also providing added transparency for consumers and investors alike, it must widen the scope of companies it covers, rather than create potential loopholes by which businesses can evade liability through structural change or creative accounting. Excluding SMEs also excludes many informal businesses, where some of the most precarious and vulnerable workers can be found.

The UNGPs provide that the corporate responsibility to respect human rights *'applies to all enterprises regardless of their size, sector, operational context, ownership and structure'*, whilst acknowledging that *'the scale and complexity of the means through which enterprises meet that responsibility may vary according to these factors and with the severity of the enterprise's adverse human rights impacts'* (Guiding Principle 14). The Directive should include SMEs within scope based on the principles of proportionality and risk. In doing so, it would send a powerful message that human rights due diligence is to be an integral part of market dynamics, rather than a financial burden to be carried by some. It would reward those SMEs who are already invested in responsible practices. This principle of proportionality would also be in line with the European Parliament's own initiative report. Today's SMEs may grow to become large companies. The Directive must ensure that it is fostering the growth of responsible business models that value people and planet, rather than allowing poor practice to give growing companies a commercial advantage.

Recommendation: Expand the scope of company inclusion to include small and medium organisations, based on the principles of proportionality, in line with the European Parliament's own initiative report.

vi. **Established business relationships**

The Directive introduces the term *'established business relationships'* to limit the scope of expected due diligence. However, it is not necessarily the *'established business relationships'* that we expect to be the biggest cause of human rights impacts. Risks often exist in the relationships that would be considered *'ancillary'*. The Directive's recitals mention raw material sourcing and waste disposal as particular areas where adverse impacts occur and emphasise that *'in order for the due diligence to have a meaningful impact, it should cover human rights and environmental adverse impacts generated throughout the life-cycle of production and use and disposal of product or provision of services, at the level of own operations, subsidiaries and in value chains.'*[xvii] As explored in depth by ETI member WIEGO (Women in Informal Employment: Globalizing, and Organizing), waste picking is a good example of a remote sector, predominantly populated by informal workers, where human rights violations are rife. Waste pickers generate considerable environmental, economic, and social benefits for the cities in which they work.[xviii] Their work includes the collection of plastics for recycling that make their way into the products of many businesses. Yet through a focus on *'established business relationships'*, the Directive does not include them in its scope, despite the recitals acknowledging the importance of doing so.

Whilst we recognise the challenge of accessing and supporting these workers and others in a range of relationships that may be considered *'ancillary'*, the solution must not be to legitimately exclude them from the scope of due diligence. The Directive should align with the UNGPs and OECD guidelines which demand due diligence across the full scope of the supply chain but allow for prioritisation based on severity and likelihood of risk and impact. The focus of business activity in human rights due diligence must be the risk of harm to rights holders, not the ease with which companies are able to undertake said activity.

The limitation of '*established business relationships*' may also create a risk of incentivising certain companies to favour more ad hoc relationships, increasing churn within supply chains and undermining the long-term relationships that are vital to effective human rights due diligence. This would contradict the concept of due diligence as set out in the UNGPs, and potentially undermine the effectiveness of this legislation, which conveys the need to invest in long-term business relationships in which companies are called to use their leverage to effect change in the wrongful practices of their business partners.[xix]

Recommendation: Remove the limitation of the legal duty only to '*established relationships*'. Align with the UNGPs by demanding **due diligence across the full scope of the supply chain** but allow for **prioritisation based on severity and likelihood of risk and impact.**

vii. High-risk sectors

We acknowledge the focus on high-risk sectors, and see the value in this, however this methodology risks excluding other high-risk supply chains from the due diligence they warrant. The draft Directive's list of '*high-risk sectors*' has been defined based on where there is existing OECD Guidance but excludes a number of sectors which are internationally recognised as high-risk sectors for forced labour.[xx] For example, according to the ILO's Global Estimates of Modern Slavery, 18% of victims of forced labour exploitation are in the construction sector, 15% are in manufacturing (which includes not only garments, but also electronics and personal protection equipment, for example), and 10% are in accommodation and food service activities.[xxi]

It is also important to recognise that the world of work is evolving rapidly. Limiting legislation to established industries misses the opportunity to embed effective human rights due diligence into the practices of emerging business models and risks new and emerging human rights violations going undetected. For example, advancement in technology has driven the rapid expansion of the gig economy and of mechanisation, bringing with it a rise in precarious work and new challenges to detecting and addressing risks to people.

Identifying high-risk factors, such as significant volumes of migrant labour, seasonal labour, or gender imbalance, in addition to sectors and as an extra means to identify high risk sectors, would help to future-proof legislation in a rapidly changing global landscape. In the face of geopolitical instability and climate change, the Directive should demand enhanced human rights due diligence for areas affected by conflict, ecological disaster, or other significant unrest.

Recommendation: Specify a non-exhaustive number of high-risk factors, in addition to sectors, that companies need to take into consideration, such as significant volumes of migrant labour, seasonal labour, informal labour such as home-based labour, poverty, gender imbalance, conflict affected areas or ecological disasters. **Periodically review the list of high-risk sectors** and factors as new information and data comes to light.

viii. Severe impacts

The Directive states that '*large*' companies within the named high-risk sectors must conduct due diligence on severe impacts only in the specified sectors. Typically, if one type of rights abuse is found, there are other abuses and risks present which need to be addressed and can help understand root cause analysis. Limiting due diligence to severe impacts could result in companies not addressing foundational labour rights as outlined in the ETI Base Code, including freedom of association.

Hindering due diligence by looking for the most egregious forced labour only is not in line with UNGPS and is not in the spirit of the Directive.

Recommendation: Remove the exemption that '*large'* companies within the named high-risk sectors must conduct due diligence on '*severe impact only*'. Align with the UNGPs by demanding **companies address all risks but** allow for **prioritisation based on severity and likelihood of risk and impact.**

ix. Financial sector

The Financial sector has both a direct and indirect impact on supply chains creating incentives or disincentives for responsible behaviour. The Draft Directive applies to financial sector companies but introduces significant exemptions. The limitation to pre-transactional screening not only deviates from the UNGPs and OECD Guidelines' approach, but also from the existing financial sector practice and industry standards that are based on these frameworks and already being utilised.

Risks to human rights come to light in the implementation rather than the proposal '*pre-transactional'* stage of an investment. Limiting the finance sector's due diligence responsibilities to pre-transactional screening will be ineffective from a due diligence perspective and will miss employing the financial sector's significant leverage.

With regards to size, only '*very large'* financial institutions currently fall under the scope of the Directive. Considering the significant influence of the finance sector as a whole, not just very large institutions, this limitation misses the opportunity to make human rights due diligence a standard feature of how business is done, right from the point of investment and as an ongoing duty. The Directive should support responsible financial institutions, by raising the legislative standard to align with best practice in the sector.

Recommendation: Remove all exemptions on the financial sectors' due diligence obligations from Articles 6(3), 7(6) and 8(7).

3. Include sufficient enforcement mechanisms and establish clear, transparent systems that enable workers to access effective remedy

The UNGPs set out that states and businesses should both work to provide remedy when rights are violated. For this to happen, workers need to be safe and able to raise grievance without fear of prejudice. Pathways to remedy need to be accessible within the financial, educational, and general means of those harmed, and compensation needs to be appropriate and worth the effort and upheaval of accessing it.

x. Complaints procedures

Operational-level grievance mechanisms (OGMs) can take many forms, but they need to be carefully designed and implemented if they are to be effective for workers. ETI's Access to Remedy Principles set out how businesses and other stakeholders can, collaboratively, establish OGMs that provide meaningful access to remedy for workers. The principles raise a range of considerations such as safeguarding of victims, consultation with workers '*where possible through dialogue with trade union representatives*', and intersectional vulnerabilities, '*such as women migrant workers who have enhanced vulnerability to sexual abuse and can be subject to gender-based discrimination which may discourage them from raising a grievance*'.[xxii]

Article 9 of the Directive requires companies to put in place grievance mechanisms. However, whilst Guiding Principle 31 of the UNGPs sets out a list of criteria to ensure the effectiveness of such mechanisms, such as accessibility and transparency, this is absent from the Directive.

To achieve its intended purpose, Article 9 must go beyond simply demanding the existence of OGMs and specify a list of criteria that ensures they are accessible and beneficial to workers, including children and others in situations of heightened vulnerability.

Recommendation: In Article 9, **explicitly mention the criteria** set out in Guiding Principle 31 of the UNGPs **to ensure the effectiveness of non-judicial grievance mechanisms.**

xi. Civil liability and burden of proof

Civil liability is important both as an incentive for companies to undertake effective human rights due diligence and as a means by which affected individuals can access remedy. However, the provision for civil liability as drafted in Article 22 risks missing the opportunity to influence effectively in both respects.

The Draft Directive offers that companies can defend themselves against liability where they can demonstrate compliance with Articles 7 and 8. Where the harm results from the activities of an '*indirect'* business partner, this can be done through contractual assurances, (unless it is '*unreasonable, in the circumstances of the case, to expect that the action actually taken, including as regards verifying compliance, would be adequate to prevent, mitigate, bring to an end or minimise the extent of the adverse impact*.') Compliance with such contractual assurances may be verified using '*suitable industry initiatives or independent third-party verification'*. With the aforementioned limitations of Articles 7 and 8, this provision risks incentivising weak human rights due diligence systems through an over-reliance on or misuse of contractual assurances, suitable industry initiatives and third-party verification. For indirect relationships, it risks enabling suitable industry initiatives and third-party verification to become liability loopholes.

Notably, the Draft Directive makes no mention of burden of proof. It is therefore likely that it will fall to the under-resourced plaintiff to demonstrate the inadequacy of the business's actions to prevent, mitigate, bring to an end or minimise an impact.[xxiii] The enormous barriers this poses for claimants has been documented[xxiv] by civil society.[xxv] For Article 22 to enable affected individuals to actually access remedy, it must be clear that the burden falls to the company to '*prove that it could not have done more to avoid the causation of harm, once the victim has proven the damage inflicted and the connection to the business activities of the company'*.[xxvi]

Recommendation: In Article 22(2), **remove the function of contractual assurances, industry initiatives, and third-party verification to validate the appropriate implementation of due diligence.** In Article 22, specify that the burden falls to the **company to prove that it could not have done more to avoid the causation of harm,** once the victim has proven the damage inflicted and the connection to the business activities of the company.

xii. Transparency and reporting

The complexity of global supply chains can result in a profound lack of visibility, bringing significant risks for workers. Momentum around demands for greater transparency continues to gather pace, with many responsible businesses rising to meet this demand. Legislation is needed to support this progress and ensure openness and transparency become the norm for companies across industries.

As explored in ETI's 'towards greater transparency: the business case', transparency enables collective action with civil society organisations. Sharing information with key stakeholders is the best way to create opportunities for joint action, among companies, trade unions, NGOs, and others, leading to more effective solutions to supply chain problems that cannot be tackled by one company alone. It enables better flow of information from the supply chain, leading to more informed decision-making, and allows brands to work with suppliers to resolve problems before they reach levels of crisis. Effective due diligence is achieved through driving partnerships that identify the common interest in eliminating

human rights risks. Lead firms demonstrating a willingness to be open and transparent can help to set the culture of honesty, openness, and shared responsibility for human rights risk needed to effectively tackle root causes.

ETI members are demonstrating the willingness and ability of companies to act this area. Our new Corporate Transparency Framework sets out minimum, good and best practice requirements in human rights reporting, for example with regards to governance and accountability structures, supply chain geography and risk, respect for trade union rights including respect for freedom of association and collective bargaining, and actions taken to mitigate risk or remediate harm. The Directive should leverage the power of civil society and trade unions to support human rights due diligence efforts and support responsible companies by raising the legislative bar to meet existing good practice.

Recommendation: Require companies to continually disclose key information relevant to human rights due diligence processes, such as governance and accountability structures, supply chain geography and risk, respect for trade union rights including respect for freedom of association and collective bargaining, and actions taken to mitigate risk or remediate harm.

xiii. Harmonising consistency across states

To achieve its aim of creating a level playing field for business, there must be consistency in how the Directive is adopted, implemented, and enforced across the EU's 27 member states. An effective regulatory body is crucial to the success of the legislation. The commission must take a leading role in putting in place mechanisms to ensure this harmonisation. We would also recommend that the EU encourages its major trading partners to introduce similar human rights due diligence legislation.

Recommendation: The Commission should put in place mechanisms to **ensure minimum standards and harmonisation** in how the Directive is adopted, implemented, and enforced across the EU's 27 member states.

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