

## Responsibility towards society and the environment: businesses and their due diligence obligations

### Background paper from the research project commissioned by the Federal Environment Agency

Companies are playing an increasingly important role in the context of globalisation and transnational flows of goods. Their actions can have both positive and negative effects on the environment and on people's living and working conditions. Companies are therefore increasingly expected to take responsibility for the (global) impact of their business activities and relationships, thereby contributing to the achievement of the sustainable development goals.

Since the adoption of the United Nations Guiding Principles for Business and Human Rights (UN Guiding Principles) in 2011, this corporate responsibility has been increasingly discussed under the heading of corporate due diligence. Although the concept of "due diligence" is not new and is already applied in various areas of law, the UN Guiding Principles have had a decisive influence on the more recent discourse and have triggered a number of developments. These include the development and implementation of national action plans, the revision of existing corporate responsibility standards and the creation of new legislation, voluntary industry initiatives or certification schemes.

Corporate due diligence obligations are also getting attention due to the fact that they cover a wide range of corporate responsibilities and take into account their entire value chain. Due diligence therefore also represents an opportunity to address negative social and environmental impacts of companies, particularly in areas where national environmental and social standards are low or insufficiently enforced.

As part of a research project commissioned by the Federal Environment Agency, environmental and human rights due diligence are being examined as a means to strengthen responsible business conduct (FKZ 3718 13 102 0). The project is devoted to a detailed analysis of the genesis and status quo of the concept of due diligence and is intended to highlight ways in which companies can voluntarily comply with their environmental and human rights due diligence obligations, but also how due diligence could be legally required. This background paper summarises the main findings of the first project report<sup>1</sup> and focuses in particular on the following aspects:

- ▶ Classification of corporate due diligence obligations in existing concepts and approaches to corporate responsibility,
- ▶ Environmental due diligence obligations,
- ▶ Comparison of primary due diligence standards and regulations,

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<sup>1</sup> Scherf et al. (2019): Environmental and human rights due diligence as an approach to strengthening sustainable corporate management. Sub-report WP 1 Analysis of the genesis and status quo. Available at: <https://www.umweltbundesamt.de/publikationen/umweltbezogene-menschenrechtliche>, last accessed on 03.09.2019.

- The role of environmental management systems in meeting environmental due diligence obligations,
- Synergies with non-financial reporting.

### **The concept of corporate due diligence with respect to human rights and the environment**

The aim of corporate due diligence is for companies to identify and address potential and actual negative effects of their activity on individuals, society or the environment. In doing so, they focus on impacts on third parties and not on risks that arise for the company itself.

The UN Guiding Principles and subsequent standards specify that companies must address not only those adverse impacts caused through their own activities, but also those to which they contribute or to which they are directly linked through their business relationships. Their concrete obligations vary depending on the degree of involvement: if a company potentially or actually causes or contributes to negative impacts, it should take the necessary measures to cease or prevent them. Where companies are directly linked to an adverse impact, on the other hand, they are expected to use their leverage to avoid or mitigate the adverse effects.

Due diligence is largely limited to procedural obligations, i.e. the implementation of and compliance with certain procedures. Due diligence standards and relevant legal provisions prescribe certain steps, including issuing a policy, performing a risk analysis, undertaking measures, reporting on their efforts or establishing effective complaints mechanisms. Companies are then largely free to decide on the concrete form of the individual steps. For example, the companies themselves prioritise their risks and impacts and decide which measures they consider appropriate and ultimately implement. Essentially rules of conduct, the concept of due diligence relies substantially on the individual responsibility of the companies and their self-regulation.

#### **Key elements of the due diligence process<sup>2</sup>**

- Policy
- Assessment of actual and potential adverse impacts
- Implementation of (counter-)measures and tracking of their effectiveness
- Reporting
- Establishment of effective complaints mechanisms

Underlying to the concept of due diligence is thus a more specific focus than is the case for other prominent current concepts of corporate responsibility such as ‘corporate social responsibility’ (CSR), ‘environment, social and governance’ criteria (ESG) or ‘corporate sustainability management’. Namely, due diligence focuses on the adverse impacts of entrepreneurial activity, although companies can of course also bring about positive social and ecological effects (e.g. development of environmentally-friendly technologies). The identification and prioritisation of salient risks is explicitly provided for. The due diligence process is therefore often described as a management system designed to prevent, mitigate, cease or remedy adverse impacts on people

<sup>2</sup> Based on the Nation Action Plan for Business and Human Rights of the German Government 2016-2020, available at: <https://www.auswaertiges-amt.de/blob/297434/8d6ab29982767d5a31d2e85464461565/nap-wirtschaft-menschenrechte-data.pdf>, last accessed on 01.08.2019.

and the environment. Due diligence can thus be understood as part of corporate sustainability management.

### **Environmental protection in the context of due diligence obligations**

Environmental protection is taken into account to differing degrees in due diligence standards and legal provisions.

In the case of the UN Guiding Principles, which focus exclusively on human rights, environmental impacts play a role whenever they lead or could lead to human rights violations. The fact that humankind is in many ways and often directly dependent on the environment, and that the protection of natural resources is thus a prerequisite for the protection of human rights, has been discussed and emphasized since the very beginning of international environmental policy. It is also undisputed that procedural rights such as access to information or access to justice play an important role in environmental protection. At times, however, the protection of the environment can also conflict with the protection of human rights objectives (e.g. employment in environmentally harmful activities).

With the integration of the concept of due diligence into other standards and legislation, environmental concerns no longer only play an indirect role. Certain standards and legislation indeed provide for environmental due diligence that applies regardless of whether environmental damage also leads to human rights violations. The standards and legal provisions also differ in their scope and responsibilities, as shown in the following section.

### **Due diligence standards, legal provisions and their interplay**

The concept of due diligence was taken up in a number of existing standards following the adoption of the UN Guiding Principles. Comprehensive standards of corporate responsibility such as the Guidelines for Multinational Enterprises of the Organisation for Economic Co-operation and Development (OECD) and the international standard DIN ISO 26000 integrated the concept (see Table 1). The OECD has also published various sector-specific guidances designed to assist companies in fulfilling their due diligence obligations. Moreover, the concept has been taken up by various industry initiatives, which are not, however, examined in greater detail within the framework of this research project.

Recent legislation has also established due diligence obligations for companies, including the European Union (EU) Timber Regulation, the EU Conflict Minerals Regulation, and the French Corporate Duty of Vigilance Law. The EU Non-Financial Reporting Directive also touches on the concept of due diligence, as it requires affected companies to report on their due diligence processes, among other things (see Table 2).

The far-reaching influence of the UN Guiding Principles becomes clear when looking at the various standards and legal provisions considered here. Almost all of them rely on the UN Guiding Principles' terminology and key requirements for the due diligence process (key elements).

Differences, on the other hand, can be identified with regard to the scope of application and the target group. For example, the OECD guidances, EU Conflict Minerals Regulation and EU Timber Regulation each only address companies in certain sectors or selected activities of the value chain. Furthermore, most legal provisions only apply to companies exceeding a certain size.

The standards and legal provisions also address different issues, risks and legal interests. The spectrum ranges from a focus on illegal logging (EU Timber Regulation) and human rights (UN Guiding Principles) to comprehensive solutions, such as the French Corporate Duty of Vigilance Law or the OECD Guidelines, which cover human rights, the environment, ethical business practices and other issues. As explained above, depending on the standard or legislation,

environmental concerns play not only an indirect role – i.e. where environmental damage leads to human rights violations – but rather are addressed through environmental due diligence obligations.

The standards and legal regulations further differ in the responsibility they assign to companies. While the UN Guiding Principles' involvement terms 'cause', 'contribute to' and 'directly linked to' are explicitly adopted in almost all of the non-binding standards, the same does not apply to the legal provisions. Nonetheless, most of the latter provide for a graduated responsibility depending on the risk, proximity to the adverse impact in question or the company's exercise of control and influence. The legal provisions also differ with respect to whether they provide for civil law mechanisms in addition to the due diligence obligations under regulatory law.<sup>3</sup>

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<sup>3</sup> See Scherf et al. (2019): Environmental and human rights due diligence as an approach to strengthening sustainable corporate management. Sub-report WP 1 Analysis of the genesis and status quo, p. 39ff. Available at: <https://www.umweltbundesamt.de/publikationen/umweltbezogene-menschenrechtliche>, last accessed on 03.09.2019.

**Table 1**      **Overview of relevant corporate due diligence standards**

	<b>UN Guiding Principles on Business and Human Rights</b>	<b>German Nation Action Plan for Business and Human Rights</b>	<b>OECD Guidelines for Multinational Enterprises</b>	<b>OECD Due Diligence Guidance for Responsible Business Conduct</b>	<b>DIN ISO 26000</b>
Regulatory goals and purpose	Standard for corporate responsibility and human rights due diligence	Implementation of UN Guiding Principles at national level	Standard for corporate responsibility and due diligence, esp. for multinational companies	Handout on corporate due diligence	Guidelines for corporate responsibility
Key elements (1 – 5)	1) Policy, 2) Risk assessment, 3) Measures, 4) Reporting, 5) Complaints mechanisms	1) Policy, 2) Risk assessment, 3) Measures, 4) Reporting, 5) Complaints mechanisms	1) Policy, 2) Risk assessment, 3) Measures, 4) Reporting, 5) Complaints mechanisms	1) Policy, 2) Risk assessment, 3) Measures, 4) Reporting, 5) Complaints mechanisms	1) Policy, 2) Risk assessment, 3) Measures, 4) Reporting, 5) Complaints mechanisms
Target group	All companies	All companies	All companies	All companies	All companies
Area of responsibility	Entire value chain; concrete obligations differ according to level of involvement	Entire value chain; concrete obligations differ according to level of involvement	Entire value chain; concrete obligations differ according to level of involvement	Entire value chain; concrete obligations differ according to level of involvement	Entire value chain; concrete obligations differ according to level of involvement
Thematic scope	Human rights	Human rights	Human rights, employment, environment, corruption and bribery, consumer protection	Human rights, employment, environment, corruption and bribery, consumer protection	Human rights, social and labour concerns, environment

Source: own table

**Table 2 Overview of relevant corporate due diligence legislation and legislative proposals**

	<b>EU Non-Financial Reporting Directive</b>	<b>EU Conflict Minerals Regulation</b>	<b>French Corporate Duty of Vigilance Law</b>	<b>EU Timber Regulation</b>	<b>Swiss Responsible Business Initiative</b>
Regulatory goals and purpose	Regulation on the disclosure of non-financial information by companies	Regulation of due diligence obligations in the context of the import of certain minerals from conflict-affected and high-risk areas	Regulation of comprehensive corporate due diligence obligations ("vigilance plan")	Regulation of due diligence obligations in the context of placing illegally harvested timber on the EU market	Regulation of comprehensive corporate due diligence obligations in the context of corporate responsibility
Key elements (1 – 5)	1) Policy* 2) Risk assessment* 3) Measures* 4) Reporting 5) Complaints mechanisms* * not explicitly required	2) Risk assessment 3) Measures 4) Reporting 5) Complaints mechanisms	2) Risk assessment 3) Measures 4) Reporting 5) Complaints mechanisms	2) Risk assessment 3) Measures	2) Risk assessment, 3) Measures, 4) Reporting, 5) Complaints mechanisms
Target group	Listed companies, financial institutions and insurance companies with more than 500 employees	Importers of minerals in the form of mineral ores, concentrates or processed metals above a certain import volume	Companies with more than 5,000 employees and headquartered in France or with more than 10,000 employees worldwide	Companies placing timber or timber products on the EU market for the first time; timber traders	Companies domiciled in Switzerland; SMEs only when active in a high-risk sector
Area of responsibility	Entire value chain, as appropriate	Upstream value chain	Entire value chain	Upstream value chain; differing levels of responsibility	Entire value chain; Liability limited to controlled companies
Thematic scope	Environment, social and labour issues, human rights, corruption and bribery	Human rights violations and other adverse impacts related to conflict minerals and the financing of armed conflicts	Human rights and fundamental freedoms, health and safety, environment	Illegal logging; formal land rights	Human rights and environment

Source: own table

The non-binding standards and legal provisions interact in different ways. On the one hand, both define corporate due diligence obligations largely in line with the UN Guiding Principles. The EU Conflict Minerals Regulation also draws upon the OECD Due Diligence Guidance for Responsible Supply Chains of Minerals from Conflict-Affected and High-Risk Areas. Where such content orientation is not explicitly provided, the legal provisions are at least open to the incorporation of non-binding and/or non-governmental standards (e.g. EU Non-Financial Reporting Directive and French Corporate Duty of Vigilance Law).

In addition, established management systems such as product certifications or environmental management systems can play an important role in the (partial) fulfilment of due diligence obligations. This also corresponds to the understanding of corporate due diligence of the standards and legal regulations examined. These do not require companies to establish entirely new systems and procedures, but rather encourages them to build on existing systems.

The EU Timber Regulation and the EU Conflict Minerals Regulation even explicitly provide for the recognition of certain existing systems. The former recognises timber products to be legally logged where they have been obtained with a permit in accordance with the EU Forest Law Enforcement, Governance and Trade (FLEGT) Action Plan or the provisions of the Washington Convention on International Trade in Endangered Species of Wild Fauna and Flora (CITES). For these supplies companies are then exempt from the regulation's due diligence provisions. The EU Conflict Minerals Regulation, on the other hand, recognises certain due diligence systems that may be developed by governments, industry associations or other organisations.

Finally, interdependencies can also arise in civil liability with regard to clarifying the company- or supply chain-related scope of responsibility, as courts can refer to non-binding standards when determining the due diligence required in individual cases.

### **The role of environmental management systems in meeting environmental due diligence obligations**

While few companies currently have dedicated management systems for human rights, environmental management systems are already established in a larger number of companies.

Environmental management systems previously focused primarily on direct environmental impacts (e.g. energy and material efficiency at specific sites). However, the most recent revision of the international environmental management standard ISO 14001 in 2015 and the amendment of the European Regulation for the Eco Management and Audit Scheme (EMAS) in 2017 and 2018 have strengthened aspects that are particularly relevant to the exercise of environmental and human rights due diligence. These include the increased consideration of indirect environmental impacts resulting from upstream and downstream stages of the value chain as well as of the views and expectations of relevant stakeholder groups, when determining the significant environmental impacts of an organisation.

EMAS and ISO 14001 also offer potential synergies with regard to the key elements of corporate due diligence (see Table 3). In order to leverage these synergies, the environmental management system can be integrated into the company's greater due diligence processes.

Nevertheless, the standards do differ in some respects. Environmental management systems, for example, consider both positive and negative environmental aspects and impacts. In addition, they only provide for the prevention and mitigation of adverse environmental impacts, but not for their cessation and remediation. They also do not require companies to set up an effective complaints mechanism.

Finally, it should be noted that the revised versions have only been published or in force for a short time. Transitional periods also apply in certain cases. Taking into account that many companies in the past introduced environmental management systems to address and improve

their direct environmental impacts, it remains difficult to predict the extent to which the before mentioned synergies will be leveraged in the context of corporate due diligence.

**Table 3 Comparison of environmental management systems and corporate due diligence standards**

	Due diligence standards (e.g. UN Guiding Principles on Business and Human Rights)	EMAS	ISO 14001
Goal and purpose	Standard for corporate responsibility and due diligence +	Management system to improve environmental performance	Management system to improve environmental performance
Key elements (1-5)	1) Policy, 2) Risk assessment, 3) Measures, 4) Reporting, 5) Complaints mechanisms	1) Policy, 2) Risk assessment, 3) Measures, 4) Reporting	1) Policies, 2) Risk assessment, 3) Measures
Target group	All companies	All companies and other organisations	All companies and other organisations
Area of responsibility	Entire value chain and all business relationships	All activities, products and services of an organisation within the scope of the environmental management system	All activities, products and services of an organisation within the scope of the environmental management system
Thematic scope	Human rights, social and environmental impacts, depending on the standard	Direct and indirect environmental impacts	Direct and indirect environmental impacts

Source: own table

### Due diligence in the context of non-financial reporting

As described above using the EU Non-Financial Reporting Directive as an example, the link between due diligence and sustainability or non-financial reporting is foremost that companies must provide information on, among other things, their due diligence processes, identified risks and measures taken. Companies can herewith fulfil their duty to report, as foreseen by the key elements of the UN Guiding Principles.

Such synergies are also evident in the reporting standards of the Global Reporting Initiative (GRI), currently the most widely used international standard for sustainability reporting. According to GRI, companies should, among other things, provide information on their management approach that theoretically covers all key elements of the due diligence process. However, many of the disclosures are only required for those *issues* identified as material. These may or may not correspond to the company's salient *impacts* on people and the environment as the GRI reporting standards define materiality not only in terms of impacts on people and the environment, but also in terms of risks and opportunities that arise for the company. In contrast to due diligence, GRI also considers both the negative and the positive impacts of corporate activity.

Lastly, it should be noted that from reporting on a specific issue it cannot automatically be derived that the company has indeed established appropriate systems and processes and performs well in terms of sustainability.



## Conclusions, need for action and further research

The comparison shows that there are now a number of voluntary standards and binding legal provisions on corporate due diligence which are largely based on the UN Guiding Principles. There are also many other approaches such as industry initiatives, product certifications or environmental management systems, that can be used by companies to fulfil their due diligence obligations.

While the UN Guiding Principles have foremost shaped the discourse on human rights violations in the context of corporate activity, environmental impacts are being increasingly considered as part of environmental due diligence and therefore independent of their human rights impact. However, certain differences to human rights due diligence may arise. For example, it is not always clear when a negative impact on the environment actually constitutes a breach of due diligence. First, there is a lack of an international framework of reference similar to that for international human rights. Legal provisions at national level or international conventions could serve as a point of reference here. Second, it is unclear at what point an adverse impact is considered appropriately mitigated (e.g. CO<sub>2</sub> emissions reduction vs. CO<sub>2</sub> compensation).

These difficulties will have to be discussed in the future, particularly in the context of legally binding solutions.

Against this background, a further concretisation of environmental due diligence seems to be urgently needed – both at the conceptual and implementation levels.

### Need for action with regards to corporate due diligence

- ▶ Due diligence obligations should be specified in standards, frameworks and legislation, including additional sector-specific guidances
- ▶ When creating new and/or revising existing standards and legislation, care should be taken to ensure their consistency and coherence
- ▶ Existing approaches at the organisational and product levels, such as certifications, should be reviewed with regard to their suitability in fulfilling due diligence obligations and further developed if necessary.
- ▶ A dialogue should be promoted between the various stakeholders, including standard-setters in the areas of due diligence and environmental management in order to ensure a common understanding and to leverage potential synergies

In addition, there is currently a lack of meaningful data on the actual implementation of due diligence by companies, both with regard to the environment and human rights. Such data is however particularly relevant with regard to the leeway companies are given in prioritising their risks and impacts and deciding which measures are “appropriate” for preventing or mitigating their adverse impacts.

### Need for further research with regards corporate due diligence

- ▶ Research on the effective design of due diligence obligations, in particular with regard to the appropriateness and suitability of corporate measures
- ▶ Research on the transferability of human rights due diligence to environmental issues
- ▶ Empirical studies on the implementation of existing standards and legal regulations and their effects within and outside of companies, as well as on the use of established approaches and systems for the fulfilment of due diligence obligations

- Empirical research on the implementation of the amended EMAS Regulation or revised ISO 14001 and their use towards fulfilling environmental due diligence obligations

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