

## **New Due Diligence Laws in Europe**

# Effective regulation of sustainability and human rights in global supply chains?

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**Christian Scheper  
Anne Engelhardt**

**After years of discussion, the European Union (EU) has adopted a directive regulating human rights and sustainability in global supply chains. Known as the Corporate Sustainability Due Diligence Directive (CSDDD), it establishes – for the first time – human rights and environmental due diligence obligations for corporate supply chains on an EU-wide basis. The directive harmonises and expands upon a number of new due diligence laws in EU Member States, including France and Germany (German Act on Corporate Due Diligence Obligations in Supply Chains – LkSG). In this Spotlight, we place the new due diligence obligations in their political context. Which problems will they solve? And will they create new ones? We explore key aspects of this issue with reference to the worst industrial accident in Brazil’s history – the dam collapse in Brumadinho. In our conclusion, we emphasise the challenges and offer recommendations for implementation.**

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### **How are human rights and sustainability currently regulated along supply chains?**

In the last 50 years, the production of goods and services has become increasingly globalised through the relocation of business segments and manufacturing stages. In this global division of labour, workers and trade unions have been considerably weakened, in structural terms, when it comes to asserting their interests vis-à-vis transnational corporations. The list of the resulting problems is long: starvation wages, discrimination, violence, lack of trade union freedoms,

various forms of forced and slave labour, child labour, a lack of occupational safety, and more. While property rights, terms of trade and investment protection are comprehensively regulated, the adoption of binding rules on working conditions, human rights and environmental protection has remained a matter for the national level. This approach is ineffective, however, as there is a global competition between business locations to adopt investment-friendly regulations. As a result, ambitious environmental and labour rights protection is rarely given sufficient priority and may, in some cases, conflict with investor interests.

As a consequence, real-world working and environmental conditions are largely the outcome of major corporations’ supply chain management. The quality of their regulation under supply contracts varies considerably. Compliance with these rules is then controlled to a large extent by profit-oriented service providers. The effectiveness of this private regulation depends largely on economic interests (e.g. image and pricing strategies) and companies’ influence along the supply chain. In addition, there are many civil society initiatives and multi-stakeholder organisations that are involved in negotiating standards or participate in their monitoring and control. Global framework agreements concluded by international trade union organisations with major corporations are also important further components of regulation. However, all these approaches can still only mitigate wide-scale human rights and environmental problems to a marginal extent.

Indeed, in some cases, private supply chain solutions have negative implications for human rights and environmental protection. The political debate centres on superficial measures by companies to improve their

image ('greenwashing') or leverage market niches, e.g. through consumer labels (e.g. Fair Trade), codes of conduct or industry standards. Meanwhile, the fundamental problem of harmful business models (e.g. fast fashion) continues to exist, with workers, trade unions and affected communities lacking effective opportunities to assert their rights.

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### The Brumadinho dam collapse: a certified disaster

One example of the inadequacies of supply chain management and privatised risk prevention is the collapse of the dam in Brumadinho, Brazil, in January 2019. This upstream dam was constructed at a tailings pond containing toxic mining waste from the disused Córrego do Feijão mine. The mine was owned by Vale, one of the world's largest extractive industry companies, which supplies iron ore to the German steel industry. The dam had recently been assessed by a Brazilian subsidiary of TÜV SÜD, the German certification services provider, and had been classed as safe. Soon afterwards, however, there was a catastrophic failure of the dam, releasing a torrent of mud and mining sludge into a valley. The disaster claimed 272 lives and destroyed the income and livelihood bases of thousands of fishers and farmers. In the wake of the disaster, Vale faced multiple lawsuits and compensation claims. Survivors are also attempting to bring TÜV SÜD to justice in Germany on charges of aggravated homicide and bribery. However, major obstacles stand in the way of transnational lawsuits of this kind, even after a disaster on this scale.

Although the Brumadinho case is exceptional in its severity, it illustrates the fatal interplay between the political characteristics of global supply chains: in a context of international locational competition, weak protection of human rights, labour rights and the environment intersects with private profit-oriented interests, ineffective monitoring systems and transnational economic dependencies.

This is where the idea for the new supply chain rules comes in: the aim is to create legislation that regulates the economic factors and dependencies that are clearly in play. Companies must act with the requisite diligence, with due regard for the risks that exist and their own opportunities to bring influence to bear.

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### The new supply chain directive

The EU directive establishes a due diligence obligation which, legally speaking, constitutes a "duty of care". This means that companies must pursue efforts aimed at effective risk minimisation, damage prevention and remediation in the event of harm; the ultimate success of these measures is not decisive. Here, the concept of "risk" does not refer to business outcomes, but to the likelihood of adverse impacts on human rights and the environment and the potential degree of severity of those impacts. In order to fulfil their due diligence

obligations, large companies must in future

- (1) regularly assess the potential and actual human rights impacts of their business activities, including their indirect impacts, and consult with potentially affected groups;
- (2) prevent or mitigate potentially adverse impacts and remediate actual adverse impacts;
- (3) review and monitor the effectiveness of measures, again in consultation with affected persons; and
- (4) document and publicly communicate efforts aimed at managing impacts and risks.

In addition, companies must publish a statement of principles on international human rights and environmental norms and establish effective complaint mechanisms for employees and other stakeholder groups.

The concept of human rights due diligence did not originate with the EU, but goes back to the United Nations Guiding Principles on Business and Human Rights (2011). Alongside the internationally recognised human rights, including the International Labour Organization (ILO) core labour standards, the EU directive also identifies key environmental aspects as protected assets. Companies face financial penalties for non-fulfilment of due diligence obligations. The precise amount of these penalties will be set in national legislation, but the directive establishes specific minimum levels so that the penalties are sufficiently onerous for companies and thus have a deterrent effect. The EU Member States now have two years to transpose the directive into national law.

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### Contested due diligence: core aspects and conflicts

As with the German Supply Chain Act (LkSG), the framing of the CSDDD proved contentious at EU level for some time. In order to secure support for the directive, the scope and effectiveness of the original drafts were substantially curtailed during the final stages. We will discuss three of the controversial issues below.

Firstly, and importantly, there is the scope of the directive. According to estimates, the CSDDD will cover only around 5,400 European companies – far fewer than intended in the original draft. Additional exemptions also apply: above all, lending and investment activities by financial market participants are not initially covered by the directive; sector lobby groups and the French government made this a condition of their support. The CSDDD does, however, include a review clause: after a corresponding impact assessment, the financial sector could be included in subsequent years. Key factors that influence and steer supply chain conditions are thus excluded for now: firstly, financial market participants do much to facilitate global business by financing projects such as dams, and secondly, investments have very considerable impacts on human rights and sustainability by promoting certain forms of economic activity and avoiding others, thereby

having a steering effect. A due diligence obligation for financial institutions would therefore make a major contribution to the effectiveness of the directive.

The scope of the protected assets was the second contested aspect. Human rights are covered in full, whereas environmental issues are only dealt with selectively. Granted, they are covered more extensively here than in the German LkSG, but climate-damaging emissions, for example, do not form part of the due diligence obligations. Instead, companies are required to draw up plans for reducing these emissions.

And thirdly, the provisions on civil liability were especially contentious. Human rights and environmental groups had called for these provisions from the start; after all, basic rights can only be asserted successfully if effective judicial remedies are available. The directive only partially fulfils these demands. It stipulates the conditions under which individuals may claim compensation for damage and simplifies some aspects of the procedures. This includes a provision that trade unions, civil society organisations and the relevant national human rights institutes may bring lawsuits in their own name. A novel aspect, from a legal perspective, is the opportunity for civil courts to apply their own national law: previously, they were required to refer to the law of the country in which the damage occurred – often to the detriment of the affected groups. However, civil society's more far-reaching demand for a reversal of the burden of proof was not adopted. In practice, this may make it difficult for injured parties to prove a failure to fulfil due diligence obligations in many cases, due to a lack of information and resources.

Nevertheless, overall, the CSDDD clearly introduces an improvement with regard to civil liability: it offers potential for civil society actors to enforce rights more effectively on a transnational basis than before. However, it maintains several barriers, particularly as regards the funding of legal proceedings and attorneys, and the difficulty of proving a failure to comply with due diligence obligations. It is not only here that the ongoing financial asymmetry between companies and injured parties along the supply chains comes into play. It is also safe to assume that accused companies will be able to mobilise more financial resources to conduct legal proceedings, compared to the plaintiffs. Trade unions and other civil society organisations will have a key role to play here, as they will be able to bring actions on behalf of the injured parties in some circumstances. To what extent the opportunities to seek judicial remedies, as provided for in the directive, can genuinely be utilised in order to bring about improvements in the supply chains will have to be determined by legal practice. Transposition of the directive into national laws, the quality of official controls and specific judicial decisions on unclear legal terms are still awaited.

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## Challenges in implementation

Even after the adoption of the directive, then, there are still many unanswered questions that must be clarified

through legal practice over the coming years. One of these questions concerns the scope of the obligations of private certification and monitoring companies. The Brumadinho case demonstrates the highly significant role played by these companies: in this instance, TÜV SÜD had – wrongly – certified that the dam met adequate safety standards. To what extent the EU directive gives rise to liability for these private regulatory bodies is still unclear. Similar questions arise in relation to multi-stakeholder initiatives engaged in certification or monitoring.

Another unanswered question concerns the appropriate type and scope of due diligence measures in individual cases. This includes the quality of participation by employees or affected communities in the risk assessment process. This is regulated in far more detail in the CSDDD – the key phrase being meaningful consultation – than in the German LkSG; however, to what extent the courts will judge participation and information to be appropriate remains to be seen. The stages of the value chain to be covered by the measures also remain a contentious issue. Again, the CSDDD goes further than the LkSG here, as it more clearly covers indirect suppliers and up- and downstream processes.

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## A milestone – but no end to the political debate

The EU directive and national due diligence laws are a key innovation in supply chain regulation. They provide a normative frame of reference and thus contribute to more intensive engagement and to dialogue between companies and public authorities, trade unions and civil society on the protected assets concerned. However, due diligence is not a clear legal standard of human rights and environmental protection, but primarily establishes new requirements for the structuring of management processes and creates new opportunities for lawsuits and complaints. Politically, then, major conflicts over supply chain regulation will continue, albeit conducted to a greater extent by legal means. This shift from the political to the legal battleground may offer advantages, as the law – due to its claim to universality – can often provide access for financially disadvantaged groups to assert their claims vis-à-vis powerful corporations. At the same time, however, legal norms are very much a reflection of existing power relations, as the many compromises and exemptions in the EU directive demonstrate. To what extent will official controls work in global supply chains, and will trade unions, environmental and human rights advocates be successful in furnishing their own proof of violations of due diligence obligations and in bringing effective complaints and lawsuits? Only time will tell.

With regard to implementation, the following will be crucial:

- 1.) Create effective opportunities for participation, as well as active channels for legal enforcement by stakeholders and their attorneys. The directive provides for stakeholder participation at various stages in the due

diligence process. However, meaningful consultation, as it is termed in the directive, and effective complaints and legal action in disputed cases are often challenging, particularly for employees if there are legal restrictions on trade union rights or companies actively obstruct union activity. The role of trade unions and advocates of workplace codetermination in processes aimed at fulfilling due diligence obligations will be crucial for effective implementation. Trade union rights are part of the human rights catalogue, but they are also a means by which to facilitate the realisation of other rights, e.g. the negotiation of fair wages and decent working time. As risk assessment processes and complaint mechanisms are aspects of due diligence, full consideration should be given to effective opportunities for employees and other stakeholders to participate in formal implementation processes.

2.) Introduce/expand appropriate transparency, capacities and control options for the public authorities. Although it is legally feasible for the authorities to gain access to major companies, stringent conditions apply in practice. Information deficits and lack of capacities on the part of the authorities are two factors that may lead to inadequate controls. The frequent allegation of “excessive red tape” by some business associations is itself an indication of the strong political headwinds against the establishment of effective controls.

3.) In line with the review clause included in the directive, broaden the scope of application in the medium term so that lending and investment activities by financial institutions are also covered by the due diligence obligations.

## Authors

Dr Christian Scheper | Senior Researcher at the Institute for Development and Peace (INEF), University of Duisburg-Essen. His research focuses on human rights and the transnational regulation of companies.

Anne Engelhardt | Researcher at the Institute for Development and Peace (INEF), University of Duisburg-Essen. She conducts research on logistics, social reproduction, occupational health and safety, labor and human rights and legal battles along transnational supply chains.

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