Ashurst

Jail Time as a Potential Penalty for Non-Compliance with Sustainability Reporting Law

How Did We Get Here?

Outpacing change

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Key takeaways

More is coming: Over the past decade, a suite of laws have been introduced imposing a range of obligations on businesses to do more in the ESG space. Early disclosure requirements were transparency-based, relying predominantly on scrutiny by civil society and the risk of reputational damage to encourage compliance. However, recent policy developments indicate that as disclosure laws strengthen and due diligence laws are introduced, so too is the level of governmental scrutiny on the effectiveness and meaningfulness of steps taken by businesses to address ESG matters. It will become increasingly challenging for businesses to simply spin a positive sustainability narrative – instead, there is an increasing expectation that businesses take concrete steps to address ESG matters. Accordingly, it is imperative for a business to work together with its advisers to implement effective measures to identify and manage ESG matters in its business and supply chains now.

ESG is more than just climate change: There is a widespread recognition that environmental, social and governance matters (including human rights) are inextricably linked in ensuring a transition to net zero that is 'just' for all. In this context, it is not enough for a business to focus its narrative simply on climate change and their transition to carbon neutrality. High profile corporate controversies have shown that shareholder value, investor returns, brand reputation and executive resignations are most impacted by social and governance matters than, for instance, emissions reduction. In this context, it is important for a business to work together with its advisers to implement a framework that addresses all elements of the E, S and G.

ESG laws abroad impact Australian businesses engaged in international activities: There are two ways in which an Australian business may be exposed to the disclosure and due diligence laws abroad:

- Australian entities with a business, or part of a business, in the relevant jurisdiction; or
- Australian businesses that are part of the supply chain of a business in the relevant jurisdiction.

Such laws have exterritorial implications not dissimilar to that of the US Foreign Corrupt Practices Act, US secondary sanctions and the UK Bribery Act. As such, Australian businesses engaged need to be at least aware of, if not familiar with, ESG-related legal developments abroad. Prudent businesses will obtain early input from their legal advisers to determine to what extent they are caught within the scope of such developments and if so, what is required of them to stay ahead of the curve.

Over the past decade, policy-makers have introduced a suite of laws and regulations imposing a range of obligations on businesses to do more in the ESG space. Early policy initiatives were transparency-based, relying predominantly on scrutiny by civil society and the risk of reputational damage to encourage compliance rather than monitoring and enforcement by governmental bodies. However, recent developments indicate a desire and willingness by policy-makers to more closely scrutinise the quality of sustainability reporting and the effectiveness of related steps taken by businesses to address such matters. This article provides an overview of that journey, highlighting some of the key themes and making some general observations regarding what may lie ahead to enable businesses to stay ahead of the curve.

Introduction

Historically, businesses largely considered environmental and social matters to fall within the scope of corporate social responsibility, which was philanthropic at heart and involved businesses voluntarily "doing good", such as community projects and charitable initiatives. However, this has changed. As investors, civil society and the broader global community increasingly expect businesses to actively manage environmental, social and governance (ESG) matters, governments and policy-makers have introduced laws and regulations which impose a range of obligations on businesses to do more in this space.

Initially, policy makers adopted a 'light-touch' approach with respect to ESG matters with 'soft law' measures such as the UN Guiding Principles and the OECD Guidelines for Multinational Enterprises, but as the ESG movement gained momentum, policy makers hardened their approach with legislative measures requiring mandatory corporate reporting and due diligence on ESG-related matters. More recently, policy initiatives in certain jurisdictions have sought to address the 'E' (environmental) and 'S' (social) aspects together with a heightened focus on the effectiveness and meaningfulness of steps taken by businesses to address ESG matters.

This article provides an overview of that journey, highlighting some of the key themes and making some general observations regarding what may lie ahead to enable businesses to stay ahead of the curve.

The UN Guiding Principles on Business and Human Rights 2011 is regarded by many as a key early milestone in this journey. The UNGP is significant because it is the first international instrument to focus on the responsibility of businesses in the human rights area, and while framed as a set of principles relating to human rights, its approach, particularly with respect to due diligence, can increasingly be seen in ESG related law, policy and practice around the world. It is widely regarded by governments and businesses as the authoritative global standard in this space.

'Soft' law developments

The UN Guiding Principles on Business and Human Rights

The year 2011 is regarded by many as a key early milestone in the ESG journey. In that year, the UN Guiding Principles on Business and Human Rights (the **UNGP**) was unanimously endorsed by the UN Human Rights Council. The UNGP is significant because it addressed the international human rights obligations and responsibilities of both States and businesses in one set of principles.

Prior to the endorsement of the UNGP, international legal declarations and conventions were primarily directed at the State and individual actors. There was a consensus that the international legal regime was broadly state-centred, with the State as the duty holder and the individuals living within its territory and/or under its jurisdiction as rights holders. There are limited circumstances under which international law instruments covering ESG matters are centred on businesses as an artificial legal entity itself (rather than individuals, corporate officials/directors, or the State) and so in this context, individual States rarely sought to directly regulate their behaviour.[1]

The UNGP shifted that – following six years of extensive multi-stakeholder consultations and research,[2] a set of guidelines were established that directly addressed the role of businesses in managing human rights impacts in their operations and supply chain. The UNGP comprises a three-pillar framework - firstly, it emphasises the State duty to *protect* human rights; secondly, it highlights the responsibility of business to *respect* human rights; and lastly, the obligation of both States and businesses to enable or provide access to *remedy* for victims of harm.[3]

The UNGP does not impose legally binding and enforceable human rights obligations on businesses and is therefore often referred to as a 'soft law' approach or instrument. However, while strictly speaking not legally binding, the UNGP is now widely regarded as the authoritative global standard for the responsibilities of businesses with respect to managing human rights impacts associated with business activity.[4] Many leading businesses have publicly committed to align with them,[5] alongside global associations and organisations such as FIFA and the International Olympic Committee.

The relationship between human rights and ESG

While originally framed as a set of principles relating to human rights, the underlying principles of the UNGP are increasingly implemented into ESG related law, policy and practice around the world (as outlined further below). Social issues (i.e. the 'S' in ESG), such as employee relations, diversity, equity and inclusion, health and safety, community relations and forced labour are all reflected in established international human rights law (for example, the International Covenant on Civil and Political Rights, the International Convention on the Elimination of All Forms of Racial Discrimination, the Convention on the Rights of the Child) . Many environmental or governance issues (i.e. the 'E' and 'G' in ESG) – such as access to water, tax fairness and climate justice – also have a clear basis in international human rights treaties and related jurisprudence (for example, the International Covenant on Economic, Social and Cultural Rights). As recognised by the UN Principles of Responsible Investment, meeting human rights expectations leads businesses to manage a range of ESG matters more effectively. [6]

The UNGP due diligence

At the heart of the UNGP responsibility of business to respect human rights is the principle that a business should avoid causing or contributing to adverse human rights impacts through its own activities and seek to mitigate adverse impacts that are directly linked to its operations products or services by its business relationships. To meet the responsibility to respect, a business must take the following three key steps:

- establish a policy commitment to meet the responsibility to respect human rights;
- undertake ongoing human rights due diligence to identify, prevent, mitigate and account for human rights impacts associated with its activities or business relationships; and
- establish and implement processes in place to enable remediation for any adverse human rights impacts where appropriate. [7]

This due diligence is distinguishable from general business due diligence (most understood in a transactional context) in that it should focus on the risk of impacts to others rather than on just the commercial risks to a business itself. Further, the scope of the diligence does not end at risk identification, but also encompasses the prevention and mitigation of such risks, as well as the communication of the results of such due diligence to relevant stakeholders.[8]

Notably, the law, policy and practice developments around the world (outlined in further detail below) requiring businesses to establish policies, undertake due diligence and remediation harks back to the three key steps set out in the UNGP that a business should take in order to respect human rights. In particular, the due diligence process envisaged by the UNGP can now be seen in the ESG related legal and policy developments around the world (as outlined further in this article below).

The Spread

The unanimous endorsement of the UNGP by the UN Human Rights Council and the overwhelming support of the UNGP by key stakeholders has seen corporate accountability norms permeate the international, regional and domestic regulatory landscape over the last decade. For instance, the UNGP has influenced and/or been integrated into the policy frameworks and guidelines of organisations such as the European Union (e.g. the EU Non-Financial Reporting Directive and its guidelines) and the Organisation for Economic Cooperation and Development (e.g. OECD Guidelines for Multinational Enterprises 2011).

The UNGP principles relating to the responsibility of business enterprises to respect human rights are also of direct relevance to the commitment undertaken by the UN Global Compact participants. For example, Principle 1 of the UN Global Compact calls upon companies to respect and support the protection of internationally proclaimed human rights and Principle 2 calls upon them to ensure that they are not complicit in human rights abuses.[9] The UNGP has also influenced reporting standards such as the Global Reporting Initiative, one of the leading voluntary ESG frameworks and standard setters, used by almost three-quarters of the 250 largest companies in the world and two-thirds of the 100 largest companies in 52 separate countries.[10]

The UNGP has also encouraged the development of national systems for the regulation of corporate human rights matters through instruments such as National Action Plans on business and human rights, National Contact Points as well as influenced rules and regulations (or revised versions of such rules and regulations) relating to a range of industries or specialised areas such as the International Organisation for Standardisation's ISO 26000 and the International Finance Corporation's Performance Standards on Environmental and Social Sustainability.

While early mandatory corporate reporting laws have contributed to greater transparency and shifted corporate behaviour, such laws do not compel a business to take any action to address the underlying issue, or to ensure that any steps taken are effective. In light of this, attempts are underway across a range of jurisdictions to strengthen mandatory corporate reporting laws by prescribing certain content to be covered, a due diligence system to be implemented and/or concrete penalties for non-compliance.

'Hard' law developments

A Light Touch – Early Mandatory Corporate Reporting Obligations

It has often been said that while some positive legislative and policy developments have taken place since the UNGP, the approach taken by businesses in implementing the UNGP falls short in creating an enabling environment for rights-respecting business practices. Accordingly, members of civil society have called loudly for more to be done to address the governance gaps in corporate accountability. In light of this, early policy initiatives focused on imposing legal disclosure requirements on businesses in an effort to encourage practices that will address a range of ESG-related matters.

The early transparency-based requirements imposed on businesses were designed to improve access to information about what companies are doing (if anything)

to identify and address the ESG risks that arise from business operations (including supply chains). The essence of this approach is that transparency will 'create a level playing field' between businesses that act responsibly and those that need to do more, and thereby 'increase competition to drive up standards'.[11] Such initiatives rely predominantly on scrutiny by civil society and the risk of reputational damage to encourage compliance rather than monitoring and enforcement by the government/the State.

An example of such transparency measures is the United Kingdom's Modern Slavery Act 2015 (**MSA**), a domestic instrument with extraterritorial reach. As mentioned above, matters falling within the scope of 'modern slavery', such as forced labour, also fall within the scope of the 'S' in ESG. The MSA requires a defined 'commercial organisation' that does business in the UK (even if they are incorporated or formed elsewhere), has a total turnover in excess of GBP 36 million and supplies goods or services to publish a statement each financial year, stating the steps it has taken (if any) to ensure that modern slavery is not taking place in its business or supply chains. Failure to comply with the reporting requirement, or making a statement that an organisation has taken no steps to combat modern slavery, may damage the reputation of the business, and it is for consumers, investors and non-governmental organisations to engage and/or apply pressure where they consider a business to fall short.[12]

Interestingly, during the public consultation on the proposed inclusion of this "transparency in supply chains" provision, the UK Government framed the objectives of the provision within the context of the UNGP, referring to its essential elements of due diligence and reporting.[13] Moreover, the reporting requirement of the MSA reflects key features of the UNGP relating to the operationalisation of the business responsibility to respect human rights, for instance, a policy commitment embedded within internal processes and due diligence (including the mapping of supply chains and risk assessment).

The mandatory aspects of the MSA for businesses are otherwise quite limited. The reporting requirement does not compel an organisation to take any action to address modern slavery, or to ensure that any steps taken are effective. An organisation only needs to report on steps that it has taken, or state that it has taken none. Further, the UK Government did not create a central repository for statements, nor is there a formal mechanism to monitor and supervise compliance. A similar set of observations may be made with respect to the Australian Modern Slavery Act 2018 (Cth) (the **Australian MSA**). As with the MSA, a subject company may disclose that it has done nothing and still comply with the Australian MSA.

Similar mandatory reporting requirements were introduced across Europe, the most notable being the EU Non-Financial Reporting Directive (the **EU NFRD**). Major EU Member States have transposed the EU NFRD into national law. The EU NFRD requires a public-interest entity and a public-interest entity that is a parent undertaking of a large group, with an average number of employees in excess of 500 (on a consolidated basis for groups), to provide a statement in their management report on non-financial matters (at a minimum, environmental, social and employee matters, respect for human rights, anti-corruption and bribery i.e. ESG) to the extent necessary for an understanding of its development, performance and position and of the impact of its activity on such matters.

The EU NFRD is much broader in subject matter scope than the MSA and Australian MSA, extending beyond modern slavery to include other ESG related matters. However, like the MSA and the Australian MSA, it is not prescriptive as to content and leaves considerable flexibility for the relevant subject entities to decide what information and level of detail it considers 'necessary' for an understanding of such ESG matters.

Around this time, the United Kingdom also amended its Companies Act 2006[14] (in implementing the EU NFRD) to require public companies with a premium listing of shares on the Main Market of the London Stock Exchange to publish a strategic report which includes, where necessary for an understanding of the development, performance and position of the group's business, details of the main trends and factors likely to affect the future development and position of the business and information about environmental matters, employees and social, community and human rights issues. Note that the FRC Guidance expressly refers to the UNGP as a source of guidance that companies can follow in whole or in part when complying with the reporting requirement.[15] Like the EU NFRD, the Companies Act is not prescriptive and allows subject companies the flexibility to determine whether they need to report on such ESG matters (because unnecessary for the relevant understanding) and if they do report, what information they provide.

Similar observations may be made regarding the limited scope of the mandatory reporting obligations of other legislative instruments such as the California Supply Chains Act, the US Federal Acquisition Regulation Final Rule Ending Trafficking in Persons, the US Dodd-Frank Act Final Rule 1502 and the EU Conflict Minerals Regulation.

Gaining Teeth – Strengthening Mandatory Corporate Reporting Obligations

The number of governments that have, or are committed to implement mandatory reporting requirements regarding ESG matters demonstrates that this is the preferred policy approach. While these efforts have contributed to greater transparency and shifted corporate behaviour,[16] corporate responses to such obligations range from 'rigorous to superficial'[17] and there is a recognition among members of civil society that even more needs to be done by governments to drive the desired level of corporate behaviour. This can be seen in the number of attempts underway across a range of jurisdictions to strengthen existing mandatory reporting requirements.

An example of such attempts can be seen with respect to the MSA. In September 2020, the UK government published a Response to the Transparency in Supply Chains Consultation, in which it committed to introduce new measures to strengthen the MSA.[18] The proposed measures include mandating areas that statements must cover, introducing a requirement to publish statements on a new digital government reporting service, introducing a single reporting deadline, and introducing a requirement for public bodies with a budget threshold of GBP 36 million or more to also report.

In addition, on 12 January 2021, the UK government announced its intention to introduce financial penalties for organisations which fail to meet their annual slavery reporting obligations under the MSA (although these fines have not yet been specified).[19] On 15 June 2021, a private bill specifying, among other things, financial and other penalties in connection with failure to meet anti-slavery obligations was introduced in the House of Lords for first reading.[20] The bill has not yet progressed any further, but it is hoped that the next UK government will pick it up.

Similar efforts are underway with respect to the Australian MSA. On 25 May 2023, a government report was tabled recommending that the Australian MSA be amended to strengthen the Act (the **Report**) by requiring a broader group of businesses to report on their efforts to tackle modern slavery along their value chain and implement a due diligence system or face concrete penalties. Under the Report, penalties for non-compliance include an offence for a reporting entity to fail, without reasonable excuse, to make a modern slavery statement, make a modern slavery statement that knowingly includes materially false information, take specified remedial action to comply with the reporting requirement, and to have an appropriate due diligence system in place.[21]

Notably, the Report highlighted that it is "incongruous" that the Act imposes a reporting duty but contains no robust procedure to ensure that duty is performed.[22] The recommendations are not binding on the government

and the government has yet to confirm its position on the recommendations. However, the Labour government has indicated it intends to strengthen Australia's modern slavery regulation and as recently as 28 May 2024, the Australian MSA was amended to establish the Australian Anti-Slavery Commissioner as an independent statutory office holder within the Attorney-General's portfolio to provide an independent mechanism for victims and survivors, business and civil society to engage on issues and strategies to address modern slavery.[23]

The EU NFRD has also been strengthened. On 5 January 2023, the Corporate Sustainability Reporting Directive (the **CSRD**) came into force.[24] The CSRD expands the scope of the reporting requirements to capture small and medium sized enterprises (approximately 11,000 entities under the EU NFRD to approximately 49,000 entities under the CSRD), broadens the range of sustainability matters relevant to businesses and introduces the "double materiality principle" whereby companies are required to disclose information not only about how their sustainability impacts affect their bottom line but also how their operations impact on sustainability factors (which is arguably more difficult to justify as being 'unnecessary').

Further, unlike the NFRD, the CSRD specifies the format of disclosure and standards that companies will have to meet for their reports. The CSRD itself does not set out any detail on the penalties for non-compliance, as it will fall on the implementing legislation of EU member states (see below, approach taken by France). It is expected that the first wave of companies reporting under the CSRD will do so for the financial year 2024, for reports published in 2025.

Transposition of the CSRD into French law

France is the first country in the European Union to transpose the CSRD into national law through an ordonnance dated 6 December 2023[25] (the **French Law**) and except for certain specified provisions, the French Law entered into force from 1 January 2024. Notably, under the French law, once a sustainability report has been prepared, in-scope companies must have the information therein certified by an auditor with appropriate expertise in sustainability matters. This auditor, appointed by the general meeting, may be a statutory auditor or an accredited independent third party organisation such as a law or accountancy firm.[26] In addition, while auditors are bound by professional secrecy, they are under an obligation to notify the public prosecutor of any criminal acts of which they become aware (an obligation statutory auditors are already familiar with for financial reporting).

The French law provides criminal sanctions for breach of the following requirements by an individual director:

- for failure to appoint an auditor or independent third-party organisation: a fine of up to EUR 30,000 and imprisonment of up to 2 years; and
- for obstructing the audit mission: a fine of up to EUR 75,000 and imprisonment of up to 5 years.

In addition, an injunction may be sought by any interested party before a court under interim proceedings to obtain disclosure of the information required under the French law and for failure to publish or the publication of partial or false information (in certain cases); and a fine of up to EUR 3,750 may be imposed, as well as the publication, either in the press or by any electronic means of communication to the public, of the decision imposing such sanction . Together, these provisions are likely to give rise to an increased level of scrutiny and risk of potential legal action or challenges relating to the absence of, or incomplete publication of sustainability information or short-comings relating to steps taken to address sustainability matters.

Other implementing instruments, including a decree and several orders are still expected to finalise and complete the transposition of the CSRD into French law. For now, France has delivered a firm message to the business community, making it clear that it is not enough for businesses to spin a positive sustainability narrative. Instead, hard data addressing the facts related to ESG matters, signed off by auditors or accredited third party organisations is expected.[27] These steps indicate a desire and willingness by policy-makers to more closely scrutinise the quality of sustainability reporting and the effectiveness of related steps taken by businesses to address such matters.

Shifting Focus - Mandatory Due Diligence Obligations

In the context of an increasing amount of pressure on governments to actively police business conduct in the ESG space, we are also starting to see policy makers move a step further by positively requiring businesses to conduct due diligence on ESG matters. Legislation has been passed in California,[28] the European Union,[29] France,[30] Germany,[31] the Netherlands,[32] and Norway[33] and proposed legislation is currently being considered in several countries including the Netherlands,[34] South Korea,[35] and Switzerland,[36] in each case, requiring mandatory due diligence to be carried out in relation to a range of ESG matters such as human rights and environmental concerns.

Arguably, the first of these is the French Loi de Vigilance 2017, which requires a company with its head office in France, and employing 5,000 employees in France, or 10,000 employees within the company and its subsidiaries in France and abroad, to publish and implement an annual 'vigilance plan' and account for how they address ESG impacts in their global operations.[37] Not unlike the principles set out under the UNGP, the vigilance plan must include risk mapping, tailored actions to mitigate risks or prevent severe impacts, an alert mechanism, and a system to monitor the effectiveness of measures implemented. French lawmakers described the law as having the dual goals of requiring companies both to act to prevent human rights and environmental abuses.[38]

The law provides for a mechanism pursuant to which a court may order a company to comply with its vigilance obligations. This includes ordering the company to develop a vigilance plan when such a plan is missing, or to improve its vigilance measures where inadequate. A court may impose a penalty for each day of non-compliance. The law also provides for civil liability. Under the law, harmed individuals may bring a civil lawsuit (based on French tort law) to seek damages resulting from a company's failure to comply with its vigilance obligations, where compliance would have prevented the harm.

While these are significant developments, neither the French Loi de Vigilance nor its counterparts go as far as to require effective due diligence to be carried out or for companies to mitigate and remedy adverse ESG impacts arising from doing business. Under the French Loi de Vigilance, a company has the flexibility to determine content and so many vigilance plans contain non-specific identification of risks.

This shortcoming is demonstrated by the various lawsuits that have been filed since the French Loi de Vigilance was adopted in 2017. For example, in October 2020, representatives of the indigenous Zapotec community of Unión Hidalgo, ProDESC and the European Center for Constitutional and Human Rights brought a claim against EDF alleging, amongst other things, that EDF's vigilance plan contains only a fragmented and non-specific identification of risks, with no appropriate measures to prevent violations resulting from the Gunaá Sicarú project.[39] As of June 2024, the Paris Court of Appeal has ruled the claim as admissible, paving the way for a consideration of its merits.

More broadly, a number of analyses have been conducted that show many companies fail to include rightsholders in their due diligence processes which in turn, raises concerns about their effectiveness.[40] Further, while a large number of companies set high standards for their suppliers regarding ESG standards, only a small proportion of such companies have responsible purchasing practices which gives rise to a mismatch between a company's expectations of its suppliers and their own business practices.[41]

There is now a widespread recognition environmental, social and governance matters (including human rights) are inextricably linked to ensure a transition to net zero that is 'just' for all. In this context, it is not enough for businesses to spin a positive sustainability narrative. Instead, there is an increasing expectation that businesses take concrete steps to address ESG matters in both their own operations and supply chain. Regulators and members of civil society are increasingly prepared to hold businesses accountable for any adverse impacts on the environment or human rights.

Change on the horizon – A shift in focus

The disproportionate impact of events such as COVID-19 on vulnerable workers globally has highlighted the need for stronger social safeguards. At the same time, climate change poses one of the most significant threats to human rights globally. In 2022, there were at least 10 extreme weather events that caused more than $3 billion worth of damage each and involving a substantial human cost, including millions of displaced people.[42] In this context, civil society has urgently called policy makers to bolster corporate accountability for the effectiveness and meaningfulness of steps taken by businesses to manage their ESG impact. There is a widespread call for governments and businesses to ensure a transition to net zero that is 'just' for all states, communities and vulnerable people.[43] In light of this, we can see policy makers are looking at ways to regulate the quality of the steps taken by businesses to address ESG matters. Implicit in these calls and the approach taken by policy makers is a recognition that environmental, social and governance matters (including human rights) are inextricably linked.

EU Corporate Sustainability Due Diligence Directive

An important example of this is the EU Corporate Sustainability Due Diligence Directive (the **CS3D**). On 24 April 2024, the CS3D was adopted by the European Parliament after four years in the making. In short, the CS3D requires certain EU and non-EU businesses to conduct environmental and human rights due diligence in their business and supply chains, or face concrete fines, sanctions and/or civil liability. The due diligence process required by the CS3D is generally in line with the steps outlined by the UNGP. This is a significant development in the following ways.

Firstly, it has extraterritorial implications, applying to both EU and non-EU businesses. EU companies (on a standalone or consolidated basis) with more than 1,000 employees on average and a net worldwide turnover exceeding EUR 450 million in a financial year, and non-EU companies (on a standalone or consolidated basis) generating a net turnover of more than EUR 450 million within the EU (in each case, including an ultimate parent company of a group that meets such criteria). Note that specific criteria apply for companies (or their parent companies) that operate under franchising/licensing models, and holding companies that do not have active operational or management roles.

Secondly, an in-scope business is obliged to *conduct* substantive due diligence (not just report on such steps), as well as take appropriate measures to *prevent* or *mitigate* potential adverse impacts and *remedy* actual adverse impacts on the environment or human rights arising from (a) its own operations, (b) those of its subsidiaries, and (c) upstream and downstream business partners. Limb (c) is particularly noteworthy as this means that due diligence must cover a supply chain beyond first-tier suppliers. The CS3D contains specific criteria regarding the type of the due diligence to be carried out (e.g. policies, risk management systems), the steps taken to remedy adverse impacts caused or jointly caused by the company (e.g. compensation) and the substance of environmental or human rights matters (e.g. adequate standard of living, forced labour, biodiversity). This reflects the OECD Guidelines for Multinational Enterprises 2011 and as this instrument draws on the UNGP (as noted above), the approach to due diligence in the CS3D is not unlike the principles of due diligence set out in the UNGP. To address climate change, an in-scope business is also required to adopt and put into effect a transition plan for climate change mitigation.

Lastly, there are concrete consequences for failure to comply with the CS3D. The CS3D requires EU Member States to ensure EU national authorities enforcing the CS3D are given sufficient powers and resources to initiate inspections and investigations and impose fines not less than 5% of the entity's net worldwide turnover, and issue publicity statements about the infringements. Compliance with the relevant obligations may also be used as part of the award criteria for public and concession contracts. An in-scope company also faces potential civil liability in the form of claims brought by affected persons for compensation or injunctive relief for damage caused by the company's intentional or negligent failure to comply with its due diligence obligations under the CS3D.

EU Member States now have a period of two years to implement the CS3D into national law. Like the CSRD, there is a transitional period for compliance, starting from 2027. While there is some flexibility in the way that such Member States implement the CS3D provisions, the CS3D sets a minimum standard from which Member States should not diverge. On that basis, in the years to come, we can expect to see a range of countries bring into force legislation reflecting the CS3D.

Other noteworthy developments

Alongside corporate reporting and due diligence requirements, businesses should be aware that legislatures and regulators are using other measures (such as sanctions and custom restrictions) to promote responsible business conduct on ESG matters. For example, under the Tariff Act (as amended by the Trade Facilitation and Trade Enforcement Act of 2015), the US Customs and Border Protection (**CPB**) has the ability to issue Withhold Release Orders (**WROs**) to detain imports of goods when information reasonably indicates that they were made with forced labour until/unless importers can prove the absence of forced labour in their supply chain. Since the amendment, the CPB has issued WROs to businesses based in a number of jurisdictions including China, Malaysia, Japan, India and Mexico for products made with rubber, cotton, garlic, stevia, sugar, tea, iron, gold and diamonds.[44]

There are indications that this trend will continue. The US also has the Uyghur Forced Labor Prevention Act (**UFLPA**) which establishes a rebuttable presumption that the importation of any goods, wares, articles, and merchandise mined, produced, or manufactured wholly or in part in the Xinjiang Uyghur Autonomous Region of the People's Republic of China, or produced by certain entities, is prohibited by Section 307 of the Tariff Act of 1930 and that such goods, wares, articles, and merchandise are not entitled to entry to the US. As of 5 April 2024, the CBP has issued 1,859 penalties and liquidated damages and detained and reviewed over 780 shipments related to forced labour with an estimated value of over $40 million, denying the entry of more than half of those shipments.[45] Since June 2022, US$3.32 billion worth of shipments have been impacted across businesses in the electronics, textile, industrial and manufacturing, and consumer products space as well as countries such as Malaysia, Vietnam, Thailand and India.[46] Other governments (including Canada) may introduce similar import restrictions.

Meanwhile, efforts continue on a binding treaty on business and human rights. The treaty process is further evidence that business will continue to be the subject of increasing regulatory focus in the ESG space. As mentioned above, social issues (i.e. the 'S' in ESG), such as employee relations, diversity, equity and inclusion, health and safety, community relations and forced labour are all reflected in established international human rights law, and many environmental or governance issues (i.e. the 'E' and 'G' in ESG) – such as access to water, tax fairness and climate justice – also have a clear basis in international human rights treaties and related jurisprudence. A treaty, if ratified and implemented into domestic law, would subject businesses to a range of new 'hard law' obligations, building upon the 'soft law' obligations contained in the UNGP.

Conclusion

There will continue to be greater demands for businesses to take concrete steps to address their ESG risks, alongside louder calls for businesses to transition to a lower carbon economy as part of a just and sustainable future. While legislative efforts in the past have not focused on the qualitative elements of such efforts, that is coming – as supply chain transparency and ESG due diligence requirements strengthen, so too is the scrutiny on the effectiveness and meaningfulness of steps taken by businesses in these areas. Accordingly, it is imperative for businesses to work together with their advisers to implement effective measures to identify and manage ESG matters in their business now.

Contacts

Ashurst Global Sustainability Leads

Australia

Jo En Low
Partner
T +61 2 9258 6050
JoEn.Low
@ashurst.com

Elena Lambros
Partner, Risk Advisory
T +61 7 3259 7007
elena.lambros
@ashurst.com

UK

Lorraine Johnston
Partner
T +44 20 7859 2579
Lorraine.Johnston
@ashurst.com

Eleanor Reeves
Partner
T +44 20 7859 1210
Eleanor.Reeves
@ashurst.com

Europe

Andres Alfonso
Partner
T +34 91 364 9873
Andres.Alfonso
@ashurst.com

Marina Arntzen
Partner
T +49 89 244 42 11 63
Marina.Arntzen
@ashurst.com

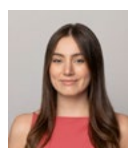
Asia

Anna Chung
Partner
T +82 2 6210 2072
anna.chung
@ashurstkorea.com

Alexander Dmitrenko
Partner
T +81 3 5405 6210
Alexander.Dmitrenko
@ashurst.com

Publication Author and Research Team

Jo En Low
Partner
T +61 2 9258 6050
JoEn.Low
@ashurst.com



Erina Higgins
Lawyer
T +61 2 9258 6322
erina.higgins
@ashurst.com

Madeleine Scott
Graduate
T +61 2 9258 6467
Madeleine.Scott
@ashurst.com

Elizabeth Hewish
Paralegal
T +61 2 9258 6484
elizabeth.hewish
@ashurst.com

Endnotes

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