



## Embedding Due Diligence Position Paper - Modint

### Background and purpose of this position paper

The global apparel industry is an industry of more than 1.5 trillion US dollars. It is widely dispersed geographically and taking the full supply chain, it is also one of the largest employers, employing some 60 million workers worldwide.<sup>1</sup> On the one hand, the industry supports the lives of millions of workers and their families. At the same time, the industry is under increased scrutiny due to the many challenges pertaining to the industry related to unsustainable production methods and overproduction, questioning the legitimacy of the industry. The current crisis caused by Covid-19 has further revealed the challenges of the business model and the fashion industry when it comes to sustainability.

The organisations behind this position paper are committed to responsible business conduct and sustainable development, as defined by the OECD Guidelines for Multinational Enterprises and associated OECD Guidelines<sup>2</sup>, the UN Guiding Principles for Business and Human Rights (UNGPR), and the UN Sustainable Development Goals (SDGs). We believe that by applying these guidelines as the normative framework for responsible business conduct, business can be drivers of positive societal change and can contribute to the fulfilment of the SDGs.

The concept of due diligence stands at the core of responsible business conduct following above guidelines. It describes the process by which businesses are expected to identify, prevent, mitigate, and account for adverse corporate impacts on human rights and the environment.<sup>3</sup> As trade associations, due diligence constitutes a key component in our guidance to the industry on responsible business conduct, and we support businesses in understanding and integrating due diligence procedures into business strategies and decision-making.

Over the past few years, the development of mandatory due diligence legislation has taken speed. A few European countries (France, UK, Netherlands) have adopted national due diligence legislation in various shapes, and debates are taking place in several other European countries (e.g. Germany, Finland, Denmark, Switzerland, Belgium). Parallel to this development, the EU Justice Chief announced in April 2020 that a proposal for a mandatory corporate environmental and human rights due diligence legislation for companies will be introduced early 2021. The key argument being that voluntary initiatives on due diligence have failed and that a general due diligence requirement for human rights and the environment could provide benefits for business by constituting a level playing field. The purpose of this paper is to communicate our position on mandatory corporate environment and human rights due diligence legislation. The paper will outline the position and propose a set of recommendations. The paper will finalise by formulating the main industry considerations, based on the practical experiences of the trade associations from working with implementing due diligence processes in the industry in practice.



## 8 Key industry recommendations to EU policy makers

We support the EU initiative to develop an EU wide framework on human and environmental due diligence.<sup>4</sup> We believe that developing a common framework carries several advantages, including a shared understanding of due diligence in practice and establishing a level playing field for business operating in the EU. Below we have formulated our key industry recommendations.

- Policy makers must develop an EU-wide approach requiring companies that sell in the EU, including companies and web-shops based outside of the EU, to carry out human rights and environmental due diligence. This alignment within the EU will also minimize confusion over many different interpretations of what responsible business conduct is and will help suppliers to work efficiently on positive impact with their business partners.
- The legislation must be based on existing international instruments as referred to above and reflect experiences and best-practices developed since the adoption of the UN Guiding Principles (UNGP) and the development of the detailed guidance from OECD on Due Diligence. This include the learnings from the Netherlands and Germany on promoting Due Diligence among apparel companies, which to a large extent have involved Small and Medium-Sized Enterprises (SME) as they constitute a significant part of the European apparel industry. We call for extensive business consultation when developing the legislation, particularly involving SME.<sup>5</sup>
- We recommend taking a flexible and adjustable approach to developing the due diligence requirements. Due diligence must be applied with flexibility and adjusted to the specific circumstances of a given company. This means that a due diligence process will differ from company to company, depending on – amongst other things – size, risk profile and complexity of the company. Therefore, very prescriptive measures can be contrary to the spirit of due diligence if it creates an Experiences from the Netherlands and Germany referred to above, have clearly demonstrated that due diligence is a process that should be adapted to the individual company and be proportionate to the size of the company, sourcing model, leverage in the supply chain and commensurate with the nature of the adverse impact. The principle of 'Reasonable Effort', as outlined in the OECD Guidance, should be applied when developing the legislation.<sup>6</sup>
- We recommend a phased approach to implementation so that businesses are given time to adjust systems and processes and to engage with their business partners. Due diligence applies to all companies along the supply chain and upstream companies should not hold all the weight nor should tier 1 suppliers.
- Following the UNGP's, the mandatory legislation should be one measure that governments apply in a broader 'smart mix' of measures. This means that other incentives also should be employed to motivate businesses and reward those businesses that have worked with embedding due diligence processes for some time. Incentives can be trade preferences and investment policies in the form of e.g. be import duties, tax benefits, credits, and credit insurances etc.



- We call for ensuring policy coherence at the EU level so that the due diligence legislation is aligned with legislative developments in other Directorates. This includes e.g. the EU Non-Financial Reporting Directive, the work on sustainable finance stream and the EU Conflict Minerals Regulation.
- EU institutions and national governments have vast procurement budgets and their procurement policies have significant impact on the behaviour of business. Making responsible business conduct one of the criteria of the EU Institutions' and Member States' procurement policies would be an important tool in promoting due diligence and responsible business conduct.
- When developing effective monitoring and enforcement mechanism, we recommend a pragmatic approach to ensure that documentation does not become an administrative burden that disproportionately impacts SME. Learnings from the textile partnerships in Germany and the Netherlands, existing due diligence legislation in UK and France and experiences from the OECD National Contact Point (NCP) systems must be considered.



## Table 1 What is due diligence?

### Important considerations:

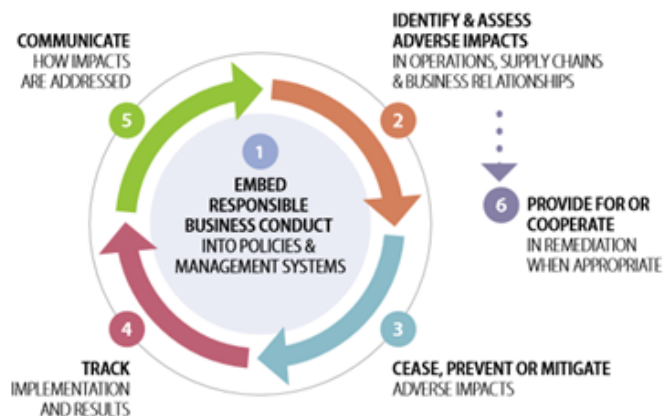
- Due diligence is a process and not a responsibility of outcome (i.e. a company should demonstrate that it has taken the right and reasonable approaches).
- Due diligence is about the quality of the process, it is not a goal at itself. Sometimes governments can hone in on discrete processes - such as traceability - while forgetting that the end goal isn't traceability but addressing risks. If a company is forced to employ expensive traceability schemes and is consequentially unable to then follow-up with meaningful actions, it's problematic.
- There is a difference between being linked to, causing or contributing to an impact.
- Due diligence is risk based
- Due diligence means provision of remedy

The concept of human rights due diligence originates from the UN Guiding Principles on Business and Human Rights (UNGPR) endorsed by the UN in 2011. The UNGPR defines the responsibility of business as the responsibility to *respect* human rights and introduces the concept of due diligence as the process by which business operationalize this responsibility. More concretely, due diligence describes a process that encapsulates the following: a commitment to respect human rights; identifying and assessing adverse corporate impacts; remediation of negative impact; tracking progress and reporting; and ensuring access to remedy. See Figure 1 below

Human rights due diligence as described in the UNGPR has subsequently been incorporated into various normative frameworks, including the OECD Guidelines for Multinational Enterprises, where it has extended to other areas of responsible business conduct such as the environment and climate change, labour rights, bribery and anti-corruption, disclosure, consumer protection and tax. Two detailed due diligence guidance documents have since been developed, one of them specifically addressing due diligence in the supply chain in the garment and footwear sector. This means that many textile and garments companies operating globally are familiar with the concept. At the same time, the guidance documents are rather comprehensive, and written with an MNE audience in mind. As a result, many Small and Medium-sized Enterprises (SME's) still struggle to comprehend and embed the process requirements.

Source: OECD Guidance for Responsible Business Conduct

FIGURE 1. DUE DILIGENCE PROCESS & SUPPORTING MEASURES



**Table 2:**

### **Due Diligence and SME's**

- Due Diligence is a process that should be proportionate to the size of the company, sourcing model, leverage in the supply chain and commensurate with the nature of the adverse impact. For SME's, the principle of 'Reasonable Effort', as outlined in the OECD Guidance, should be incorporated into EU legislation. <sup>1</sup>
- An SME apparel company must be able to defend in a structured way that it has made such a reasonable effort because it will be challenged by NGOs representing civil society. By the nature of the industry there will most often be more potential risks to adverse conditions in a supply chain than an SME company can tackle at once. The due diligence framework creates room for companies to argue why they prioritized actions over others.
- The due diligence framework helps to clarify distribution of responsibilities among buyers and suppliers. It must be remembered that manufacturers are also employers and buyers (i.e. of processes and/or materials). Suppliers at some point need to be part of the due diligence chain. They need to make the reasonable effort to prevent adverse conditions with their suppliers. Good due diligence at the same time helps to protect suppliers from unreasonable demands by their buyers. Good purchasing practices are considered to be part of the reasonable effort required of the human rights due diligence carried out by buyers. The bigger companies have more purchasing power and influence.
- For SMEs, a major value of the due diligence guidance is that it gives by far the best available framework to help a company describe that it has made a reasonable effort to mitigate adverse human rights and environmental conditions in its supply chain.

The OECD Due Diligence Guidance for Responsible Supply Chains in the garment and footwear sector describes the following:

*Page 26: Size of the enterprise: While the size of an enterprise does not change its responsibility to conduct due diligence, how an enterprise goes about applying due diligence may be affected by its size. For example, the resources, knowledge and capacity to implement due diligence may be more limited in small and medium-sized enterprises (SMEs) compared to larger enterprises. At the same time, SMEs often have smaller operations and fewer suppliers.*

*Page 55 (.....) one factories should not necessarily be prioritised over assessing more significant risks of harm at tier three). However, some factors – such as the enterprise's leverage with its suppliers, the size of the enterprise or the number of suppliers – may affect the specific steps that the enterprise may take to assesses its suppliers. See factors that may affect the nature and extent of due diligence below.*



**Table 3: Learnings of the Dutch agreement for Sustainable Garment and Textile (based on OECD)**

The due diligence approach is potentially powerful and beneficial to business and its stakeholders. But if not used correctly it can lead to extra work, confusion and frustration. So, if there is legislation, it should consider all that has been learned so far.

In General:

- Strong multistakeholder cooperation is a must to guide companies and to assess policies and procedures.
- A functioning grievance mechanism is a need for parties and workers to give access to remedy.

Regarding implementation within companies:

- Companies need a clear (assessment) framework, without creating an administrative burden.
- Supply chain partnership and sharing of risks and costs is on the basis of Due diligence. The assessment of supply chain partners, subcontractors and sub-suppliers needs a phased approach from tier one further up in the production chain. Supply chain partners need to build up a cascading effect of Due diligence.
- Companies must prioritize risks at various levels. Think of general risks at country, process or material level or specific risks at supplier level. The approach is time consuming, especially due to the nature of fast changes in fashion and must be stepwise, from first tier upstream in the supply chain, with a reasonable time frame.
- Companies must deal with a number of issues where there is room to make a difference, including an explanation which risks are not being addressed. It must be emphasized that we can expect more goals and actions from large companies than from SME's. For example, it could be sufficient for a small company to prioritize 2 or 3 concrete risks to mitigate per year that can really make a difference. This is probably insufficient for a large company.
- Theory of change: If companies have to choose between various likely and serious risks and impacts, they need to choose the risks and impacts where they can make the difference (leverage / influence). Sometimes they need to scale up to mitigate a country wide problem by reaching out to trade associations, government or via Unions and or NGO's.
- Leverage can determine the prioritisation and the approach. Leverage will be determined, among other things, by the share in the turnover of the supplier, the term of cooperation and the size of the share of the supplier in the collection. If leverage is small, a company can try to increase it using collaboration with others, but could limit prioritising the risk for mitigation.

