The Proposed Corporate Sustainability Due Diligence Directive: Corporate Liability Design for Social Harms

ANNE LAFARRE

Abstract

Several binding regulatory initiatives in ‘home states’ were recently introduced against corporate wrongdoing in global value chains (GVCs), including the French Vigilance law, the German Supply Chain Due Diligence Act, the Norwegian Transparency Act, and the Dutch Child Labour Due Diligence Act. These initiatives seem to result in a patchwork of national requirements, particularly regarding the consequences of non-compliance and enforcement. The long-awaited proposal for a European directive on Corporate Sustainability Due Diligence (CSDD) of 23 February 2022 seeks to break through this fragmentation and aims at setting harmonized ex ante incentives for corporate decision-makers to avoid and limit adverse impacts as regards human rights and environmental matters. In this article it is argued that, in contrast to the existing sub-optimal solutions like veil piercing, the CSDD’s mandatory due diligence obligations can indeed provide appropriate incentives, but selecting the right enforcement mechanisms is key for effective enforcement of these obligations. Based on existing law and economics research, this article provides some important insights for the European legislator on how corporate sustainability due diligence enforcement can best be shaped.

Keywords

Corporate sustainability due diligence, CSDD, social harm, negative externalities, corporate liability, effective law enforcement, global value chains, corporate groups, veil piercing

1. Introduction

Over the past few years, several binding regulatory initiatives in ‘home states’ were introduced to increase corporate accountability for adverse impacts in global value chains (GVCs). One of these recent initiatives is the long-awaited proposal for a European directive on Corporate Sustainability Due Diligence (CSDD) from 23

* Anne Lafarre, PhD, MSc, is associate professor at Tilburg Law School, Tilburg University, the Netherlands.

February 2022. The CSDD follows the line of action of several recent national mandatory due diligence initiatives, including the French Vigilance law, the German Sorgfaltspflichtengesetz, the Norwegian Transparency Act and the Dutch Child Labor Due Diligence Act. It is recognized that these mandatory laws have the potential to affect the incentives of corporate decision-makers by affecting risk incentives. Despite the important international value of the UNGPs, there is a strong consensus that the current international soft law framework of due diligence does not bring forward the desirable improvements. The Study on due diligence, commissioned by the European Commission (EC) that forms the basis of the CSDD, finds that companies put too large focus on the materiality of risks to the company. The latter contrasts with the UNGPs that include risks beyond this materiality perspective to third parties that are affected by corporate conduct. The introduction of mandatory due diligence regulation seems to provide the necessary next step in establishing the right ‘smart mix’ to foster companies to act socially responsible and internalize negative externalities.

However, these mandatory legislative due diligence initiatives bring forward important legal questions. Legislators should be well aware that effective enforcement of substantive law requires that liability should be appropriately allocated. Moreover, those with the appropriate incentives should be in the right position to enforce liabilities, and sanctions should be effective. Can the CSDD and other mandatory due diligence initiatives provide the right incentives to internalize negative impacts? And, what is the optimal enforcement mechanism for such due diligence obligations?

---


2 See for references to these national initiatives section 2 of this article.


9 Ibid.
In this article, it is argued that mandatory due diligence obligations that put a statutory duty of care on the (parent) company can provide appropriate incentives to internalize negative externalities in global corporate conduct, in contrast to the existing sub-optimal solutions like veil piercing. However, in order to provide the desirable incentives for corporate decision-making, selecting the right enforcement mechanism is key to effectively enforce substantive due diligence laws. The current mandatory regulatory initiatives employ different methods of law enforcement. This may signal that regulators find it difficult to determine the right techniques of due diligence law enforcement to limit adverse corporate behavior. In this research, based on the factors for effective law enforcement developed in the existing law and economics literature, we address how legal due diligence obligations that bring forward liabilities can effectively be enforced.

In Section 2, we first give a bird’s eye view of the various mandatory due diligence initiatives, and summarize our findings in Section 2.6. Afterwards, we discuss how mandatory due diligence would solve existing suboptimalities in the allocation of liability in Section 3. In Section 4 we turn to a discussion of the effective enforcement of due diligence. It is widely accepted in the law and economics literature that there are different ways to control harmful behavior and that different factors determine what would be an effective law enforcement strategy under certain circumstances. In this section, we therefore first discuss (some of) these various factors in order to establish a (non-exhaustive) framework for effective law enforcement based on existing literature. We then apply this framework to corporate sustainability due diligence to provide some recommendations for the design of the CSDD in Section 4.5. Section 5 provides concluding remarks.

2. Mandatory Corporate Sustainability Due Diligence Initiatives

2.1. The French Vigilance Law

The first general mandatory initiative that is both enacted and implemented is the French Vigilance Law from 2017 (hereinafter: French Law).¹⁰ The French Law is applicable to the largest companies, defined as companies with, including their direct and indirect subsidiaries, at least 5,000 employees in France, or with, including their direct and indirect subsidiaries, at least 10,000 employees worldwide.¹¹ These large companies need to prepare and implement a so-called ‘vigilance plan’ that includes reasonable but adequate measures to identify adverse impacts on human rights and fundamental freedoms, health and safety and the environment, and to prevent these

---


adverse impacts resulting directly or indirectly from the activities of the company and its global value chain (GVC). The vigilance duty under the French Law, however, does not cover the entire GVC like the UNGPs: the activities are limited to direct and indirect subsidiaries, and subcontractors or suppliers with whom there is an ‘established commercial relationship’ and the activities are related to this relationship. The vigilance plan needs to be prepared in collaboration with stakeholders (including multi-stakeholder initiatives) and must be effectively implemented. Particularly, the French Law lists five elements that need to be included in the vigilance plan:

i) a cartographie des risques (or risk map) for the identification, analysis and prioritization of the adverse impacts;

ii) regular review procedures regarding the activities of subsidiaries, subcontractors or suppliers with an ‘established commercial relationship’;

iii) appropriate actions to mitigate or prevent adverse impacts;

iv) a mechanism for alerting and reporting on the existence or materialization of adverse impacts, established in consultation with representative trade unions, and;

v) a system for monitoring implemented measures and evaluating the effectiveness of these measures.

The vigilance plan and the report on its effective implementation need to be disclosed in the management report. Companies that are non-compliant can – three months after they received a formal notice to comply and irrespective of actual damage has occurred – face an injunction to ensure compliance (including, if deemed necessary, a fine) and civil liability for damages initiated by a broad range of stakeholders.

Despite that the French Law is considered “the best known and most far reaching” regime of corporate sustainability due diligence, there are some important drawbacks. Particularly effective governance and public supervision mechanisms are lacking.
Various stakeholders have signaled that the vigilance plans lack meaningful information and transparency, and suffer from insufficient consultation of stakeholders. As a result, the 2020 monitoring report by the French High Council for Economy proposed the installment of a supervisory authority to overcome some of the existing flaws. In addition, the French Law also does not address the existing access to justice hurdles in civil enforcement for victims, including the burden of proof. However, since the implementation of the French Law, several civil lawsuits have been filed, which may signal its importance, although we still have to wait for the first decisions of the French courts.

2.2. The German ‘Sorgfaltspflichtengesetz’

The German Supply Chain Due Diligence Act (Sorgfaltspflichtengesetz) of 2021 takes effect on 1 January 2023 (hereinafter: German Law). The German Law applies to enterprises with at least 3,000 employees that have their seat of incorporation or headquarters in Germany (irrespective of their legal form) and to foreign companies of the same size with a domestic branch office in Germany. From 1 January 2024 onwards, the number of employees will be lowered to 1,000. The German Law covers adverse impacts regarding human rights drawn from internationally recognized human rights conventions listed in the law (including violations of human rights mentioned in the ILO Conventions like child and forced labour). Also listed adverse impacts related to environmental matters are covered by the German Law. The due diligence duties for companies under the German Law include:

---

21 Savourey and Brabant at n. 33, (n. 10) and the references mentioned therein. Also see: Clerc (n. 12).
24 For an overview of these cases: https://vigilance-plan.org/court-cases-under-the-duty-of-vigilance-law/. Also see Savourey and Brabant at n. 38, (n. 10) and the references therein.
26 Gesetz über die unternehmerischen Sorgfaltspflichten zur Vermeidung von Menschenrechtsverletzungen in Lieferketten.
27 Article 1, Part 1, Section 1(1) Sorgfaltspflichtengesetz.
28 Section 1(1) Sorgfaltspflichtengesetz.
29 Section 2(2) Sorgfaltspflichtengesetz.
30 Section 2(3) Sorgfaltspflichtengesetz.
31 Part 2, Section 3(1) Sorgfaltspflichtengesetz.
1. the establishment of a risk management system;\(^{32}\)
2. the determination of an internal responsibility;\(^{33}\)
3. carrying out regular risk analyses for their own business activities and the activities of their direct suppliers;\(^{34}\)
4. the adoption of a policy statement;\(^{35}\)
5. the adoption of preventive measures for their own business activities and the activities of their direct suppliers;\(^{36}\)
6. the adoption of remedial measures;\(^{37}\)
7. the installation of a complaints procedure;\(^{38}\)
8. the implementation of due diligence requirements in relation to risks at indirect suppliers;\(^{39}\)
9. Documentation and reporting.\(^{40}\)

These due diligence obligations signal that also the German Law largely limits the scope of the GVC, in this case to the company’s direct suppliers.\(^{41}\) Compliance with the German Law is monitored and enforced by the German public authority Bundesamt für Wirtschaft und Ausfuhrkontrolle (BAFA). Companies need to submit their due diligence reports to BAFA. BAFA has the power to inspect company reports, to carry out inspections, and adopt specific orders and measures to ensure compliance with the due diligence duties,\(^{42}\) including imposing administrative fines.\(^{43}\) These measures may be initiated by BAFA \((ex officio)\), or may take place in response to substantiated concerns from (potential) victims.\(^{44}\) In contrast to the French Law, the German Law

\(^{32}\) Section 4(1) Sorgfaltspflichtengesetz.
\(^{33}\) Section 4(3) Sorgfaltspflichtengesetz.
\(^{34}\) Section 5 Sorgfaltspflichtengesetz.
\(^{35}\) Section 6(2) Sorgfaltspflichtengesetz.
\(^{36}\) Section 6 Sorgfaltspflichtengesetz. These measures include inter alia appropriate procurement strategies and purchasing practices, offering training and obtaining contractual assurances from direct suppliers.
\(^{37}\) Section 7(1) Sorgfaltspflichtengesetz. This may include termination of a business relationship under certain circumstances.
\(^{38}\) Section 8 Sorgfaltspflichtengesetz.
\(^{39}\) Section 9 Sorgfaltspflichtengesetz. Note that when it comes to their indirect suppliers, companies are merely required to conduct a risk analysis if they obtain ‘substantiated knowledge’ that indicates the possibility of an adverse impact. Hence, the German Law does not seem to require systematic due diligence towards indirect suppliers. See Markus Krajewski, Kristel Tonstad and Franziska Wohltmann, Mandatory Human Rights Due Diligence in Germany and Norway: Stepping, or Striding, in the Same Direction? 6(3) Business and Human Rights Journal 550 (2021).
\(^{40}\) Section 10(1) and 10(2) Sorgfaltspflichtengesetz.
\(^{41}\) Krajewski et al. signal that it is also unclear whether the German Law covers the activities of those subsidiaries that are not part of the supply chain of a parent company. Krajewski et al., p. 556 (n. 39). For the duties related to indirect suppliers, see n. 39.
\(^{42}\) Sections 14-18 Sorgfaltspflichtengesetz.
\(^{43}\) Sections 23-24 Sorgfaltspflichtengesetz. Enterprises that have been fined under Section 24(2) are excluded from public procurement ex Section 22.
\(^{44}\) Section 14 Sorgfaltspflichtengesetz.
explicitly excludes any liability under civil law resulting from a violation of the due diligence obligations.\footnote{Section 3(3) \textit{Sorgfaltspflichtengesetz}. One may note that Section 11 provides victims with the right to authorise a domestic trade union or non-governmental organisation to bring civil proceedings in their own capacity.}

\subsection{The Norwegian Transparency Act}

The Norwegian Transparency Act of 2021 takes effect on 1 July 2022 (hereinafter: Norwegian Law).\footnote{\textit{Lov om virksomheters åpenhet og arbeid med grunnleggende menneskerettigheter og anstendige arbeidsforhold (åpenhetsloven)}, LOV-2021-06-18-99. Unofficial English translation available at: https://lovdata.no/dokument/NLE/lov/2021-06-18-99#:~:text=%20The%20Act%20shall%20promote%20enterprises,fundamental%20human%20rights%20and%20decent.} Like the aforementioned laws, the Norwegian Law imposes due diligence duties on certain companies. The Norwegian Law applies to larger enterprises that are resident in Norway and that offer goods and services in or outside Norway. It also applies to larger foreign enterprises that offer goods and services in Norway, and that are liable to tax to Norway pursuant to internal Norwegian legislation.\footnote{Section 2 Transparency Act.} These ‘larger enterprises’ are those that are covered by the Accounting Act, or that exceed two of the following three thresholds: i) sales revenues: NOK 70 million; ii) balance sheet total: NOK 35 million, and iii) average number of employees in the financial year: 50 full-time equivalent.\footnote{Section 3(a) Transparency Act.} The Norwegian Law adds that these conditions apply for the parent company and its subsidiaries as a whole. Although the Norwegian Law has a smaller scope in terms of adverse impacts covered, including human rights defined in line with the international framework including the UNGPs and the OECD Guidelines,\footnote{Section 3(b) Transparency Act.} and decent working conditions,\footnote{Section 3(c) Transparency Act.} it provides a broader definition of the GVC that is more in line with the UNGPs. Section 3(d) defines ‘supply chain’ as including any party in the chain of suppliers and sub-contractors that supplies or produces goods, services or other input factors included in an enterprise’s delivery of services or production of goods from the raw material stage to a finished product.\footnote{In addition, Section 3(e) adds the definition of ‘business partner’, meaning any party that supplies goods or services directly to the enterprise, but that is not part of the supply chain. Krajewski et al. note that the legal commentary states that supply chains and business partners together are meant to cover the same ‘business relationships’ like in the OECD Guidelines. Krajewski et al., p. 556 (n. 39).} Also the due diligence obligations are closely aligned with the existing international soft law due diligence framework; Section 4 of the Norwegian Law explicitly mentions that companies shall carry out due diligence in accordance with the OECD Guidelines and lists the six steps of due diligence under this framework. In addition, Section 4 makes explicit that due diligence shall be carried out regularly and in proportion to the size of the enterprise, the nature of the enterprise, the context of its operations, and the severity and probability of adverse impacts on fundamental
human rights and decent working conditions. This further emphasizes the strong alignment of the Norwegian Law with the OECD Guidelines: the OECD guidelines – with their basis in the UNGPs – recognize that due diligence is a preventative and dynamic learning process that is risk-based, which means that companies need to take into account the severity and likelihood of the adverse impact in their risk assessment, which could include a prioritization of risks. Companies are required to adopt due diligence processes in such a way that they are aligned with their size, nature of business, etc.53

Like the German Law, the Norwegian Law uses administrative enforcement. The Consumer Authority is the public authority charged with providing guidance, monitoring and enforcement, and is allowed to take measures, including a prohibition or an order, enforcement penalties and infringement penalties. Finally, note that specific for the Norwegian Law is the right to information upon written request for any person. This includes both general information about the compliance with the due diligence obligations and information about a specific product or service. This information right may serve as an accountability tool for stakeholders.62

2.4. The Dutch Child Labor Due Diligence Act

The Dutch Child Labor Due Diligence Act of 2019 (Wet zorgplicht kinderarbeid, hereinafter: Dutch Law) was supposed to come into effect on 1 January 2022, but did not enter into force (yet). The Dutch Law requires every company that supplies

---

53 OECD Guidance, ibid, p.18.
54 Section 8 Transparency Act.
55 Section 9 Transparency Act.
56 Section 11 Transparency Act.
57 Section 12 Transparency Act.
58 Section 13 Transparency Act. Section 13 explains that enforcement penalties can be established in case of non-compliance with the confirmation or decision under Sections 9 and 12.
59 Section 14 Transparency Act. Section 14 states that an enterprise may be imposed an infringement penalty when the infringement has been committed by someone acting on behalf of the enterprise. An infringement penalty for willful or negligent infringements may be imposed on natural persons. And, in the determination of the amount of the penalty, emphasis shall be given to the severity, scope and effects of the infringement.
60 Section 6 Transparency Act.
61 Note that Section 6 lists four reasons for denial of such a request, including if the request is clearly unreasonable (under b).
62 Krajewski et al., p. 557 (n. 39).
63 Wet zorgplicht kinderarbeid of 7 February 2017 as adopted by the Senate on 17 May 2019.
64 This research was finished on 23 November 2022. At that moment there was no information available about any new start date for this Dutch Law.
65 Following Article 1(d) Wet Zorgplicht Kinderarbeid, this is a company within the meaning of Article 5 of the Handelsregisterwet 2007 or any entity that carries out an economic activity, regardless of its legal form and the way in which it is financed.
goods or services to Dutch end users, regardless of whether the company is registered in the Netherlands, to issue a statement that it conducts due diligence aiming at preventing child labour from being used in the production of those goods and services. Companies need to send this statement to the Dutch supervisory authority that monitors the compliance with the Dutch Law and publishes these statements on its website. Article 5 of the Dutch Law contains the obligation to conduct due diligence. Companies must investigate whether there is a reasonable presumption that goods or services were created with the help of child labor anywhere in the GVC and must draw up and carry out an action plan if the investigation reveals that such a presumption exists. The Dutch Law adds that the investigation is aimed at sources that are reasonably known and accessible to the company. The Dutch Law does not provide any further guidance regarding this due diligence obligation, but states that more detailed requirements will become available under secondary legislation, taking into account the ILO-IOE Child Labour Guidance Tool for Business.

From this, it becomes clear that the Dutch Law takes into account the entire GVC and, moreover, does not limit the application of the due diligence obligations to large companies only. However, in contrast to the other laws, the Dutch Law takes a limited approach to adverse impacts, only addressing child labor (although being a very adverse impact to address under due diligence). The public authority will monitor and enforce compliance with the Dutch Law. Any natural or legal person whose interests have been affected by non-compliant companies can file a complaint with the public authority, but only if there are concrete indications of such non-compliance by a specific company. In addition, the public authority will only respond to complaints

66 This thus also includes online companies that supply goods or services to Dutch end-users. Note that companies that are merely involved in transporting the goods are not covered by the Dutch Law following Article 4(4) Wet Zorgplicht Kinderarbeid. In addition, Article 6 allows for the exemption of certain categories of companies from compliance through secondary legislation.

67 Article 4(1) Wet Zorgplicht Kinderarbeid. The goal of the Dutch Law that can be found in the area of consumer protection. The preamble states “a statutory basis for the requirement that companies selling goods and services on the Dutch market take all reasonable measures to prevent the use of child labour in the production of those goods and services is desirable in order to ensure that consumers can purchase those goods and services in good conscience.” Translation taken from Liesbeth Enneking, Putting the Dutch Child Labour Due Diligence Act into Perspective: An Assessment of the CLDD Act’s Legal and Policy Relevance in the Netherlands and Beyond 12 Erasmus Law Review 20 (2019).

68 To be appointed by secondary legislation following Article 1(d) Wet Zorgplicht Kinderarbeid.

69 Article 4(5) Wet Zorgplicht Kinderarbeid.

70 Article 5(1) Wet Zorgplicht Kinderarbeid.

71 Article 5(2) Wet Zorgplicht Kinderarbeid.

72 Article 5(3) Wet Zorgplicht Kinderarbeid. Also see Enneking (n. 67).

73 Note that Article 5(1) adds the following: a company that purchases goods or services from a company that has issued a statement as referred to in Article 4, fulfills its due diligence duties as regards the relevant goods or services. The company that only purchases goods or services from companies that have issued a statement as referred to in Article 4, also fulfills its due diligence duties and is not required to issue a statement as referred to in Article 4.

74 Article 3(2) Wet Zorgplicht Kinderarbeid.

75 Article 3(3) Wet Zorgplicht Kinderarbeid.
that have been filed but not have been dealt with by the company within six months or not in a satisfactory manner.\(^{76}\) The public authority can provide a binding order including a deadline for compliance;\(^{77}\) in case of non-compliance with the order, the authority can impose administrative fines\(^{78}\) and, in case of recurring offences within five years, criminal sanctions (in the form of fines and imprisonment) can be imposed on (directors of) the company.\(^{79}\)

### 2.5. The Corporate Sustainability Due Diligence Directive

The European Commission (EC) published the proposal for a directive on Corporate Sustainability Due Diligence (CSDD) on 23 February 2022. The CSDD not only introduces mandatory due diligence obligations to impact corporate behavior as regards the internalization of large social costs, it also aims at avoiding fragmentation of national due diligence requirements, creating legal certainty for companies and stakeholders as regards expected behavior and liability.\(^ {80}\) The due diligence obligations are imposed on companies incorporated in the EU\(^ {81}\) that meet certain size requirements: \(^ {82}\) companies should have more than 500 employees and have an annual net worldwide turnover of more than EUR 150 million (group 1 companies), \(^ {83}\) or 250 employees if the company mainly conducts its business in certain high-risk sectors specified in the proposal\(^ {84}\) and have an annual net worldwide turnover of more than EUR 40 million if at least 50% of this turnover is generated in these sectors (group 2 companies).\(^ {85}\) The CSDD also applies to companies in third countries that exceed certain thresholds\(^ {86}\) of turnover in the EU.\(^ {87}\) As regards the scope of the GVC, the CSDD limits the due diligence obligations to activities related to the production of goods or the provision of services by a company, including the development of the product or the service and the use and disposal of the product as well as the related

\(^{76}\) Article 3(4) *Wet Zorgplicht Kinderarbeid.* Also see Enneking (n. 67).

\(^{77}\) Article 7(4) *Wet Zorgplicht Kinderarbeid.*

\(^{78}\) Article 7 *Wet Zorgplicht Kinderarbeid.*

\(^{79}\) Article 9 *Wet Zorgplicht Kinderarbeid.*

\(^{80}\) CSDD, p. 3. This goal is also reflected in the legal basis for the CSDD, namely articles 50 and 114 TFEU.

\(^{81}\) One of the business forms listed in Annex I of the Accounting Directive. Article 3(a)(i) CSDD. Following Article 3(a)(iv) CSDD regulated financial undertakings are included regardless of their form.

\(^{82}\) Note that these size requirements are at the company level and not at the group level. See Karsten Engsig Sørensen, *Corporate Sustainability Due Diligence in Groups of Companies* 19(5) European Company Law 119-130 (2022).

\(^{83}\) Article 2(1)(a) CSDD.

\(^{84}\) High-risk sectors that are mentioned in the CSDD include three sectors: textiles, agriculture and extraction of minerals. Article 2(1)(b)(i)-(iii) CSDD.

\(^{85}\) Article 2(1)(b) CSDD.

\(^{86}\) Article 2(2) CSDD. Companies must have a turnover in the EU of more than €150 million or a turnover in the EU of more than €40 million and must have achieved at least 50% of this turnover worldwide in the risk sectors mentioned.

\(^{87}\) That are of a similar corporate form to those listed in Annex I and II of the Accounting Directive. See Article 2(2) and Article 3(a)(ii) CSDD.
activities of upstream and downstream established business relationships of the company. At the heart of the CSDD are the corporate sustainability due diligence obligations that are categorized in six actions:

(a) companies should integrate due diligence into their policies and also establish an appropriate due diligence policy that is updated annually;
(b) companies should identify actual or potential adverse impacts arising from their own activities, those of their subsidiaries and of ‘established business relationships’;
(c) companies should prevent and mitigate potential adverse impacts and bring actual adverse impacts to an end and minimize their extent using ‘appropriate measures’;
(d) companies should establish and maintain a complaints procedure. It must be possible for these complaints to be lodged by affected persons, trade unions and civil society organizations;
(e) companies should monitor the effectiveness of their due diligence policy and measures at least once a year, based on qualitative and quantitative indicators;
(f) companies should publicly communicate on due diligence. Companies not covered by the NFRD must communicate due diligence through an annual report on their website.

The EC explains that the due diligence provisions include ‘obligations of means’. The company should take appropriate measures that can reasonably be expected to result in prevention or minimization of the adverse impact. The appropriate measures

---

88 Article 3(g) CSDD. Article 3(f) CSDD defines an established business relationship as, “whether direct or indirect, which is, or which is expected to be lasting, in view of its intensity or duration and which does not represent a negligible or merely ancillary part of the value chain.”
89 Article 4(1) CSDD.
90 Article 5 CSDD.
91 Article 6 CSDD.
92 Article 7 CSDD.
93 Article 8 CSDD.
94 Article 9 CSDD.
95 Article 10 CSDD. Or rather, when there are reasonable grounds to believe that significant new risks may arise that produce adverse effects.
96 Article 11 CSDD.
98 Article 11 CSDD.
99 Preamble 15 CSDD. Here, the EC recognizes that companies are not always in the position to stop adverse impacts, for instance when these impacts result from state intervention.
for potential adverse effects that companies should take are listed in article 7 CSDD, including developing and implementing a ‘preventive action plan’ in consultation with affected stakeholders, and negotiating contractual assurances of direct business relationships and their partners (contractual cascading).\textsuperscript{100} If potential adverse effects cannot be prevented or adequately mitigated by these aforementioned appropriate measures, the enterprise should refrain from entering into new or expanding existing relationships related to those adverse effects.\textsuperscript{101} The company should also temporarily suspend the business relationship with the business partner while the company makes prevention and minimization efforts, if there is a reasonable expectation that these efforts will succeed in the short term.\textsuperscript{102} If the potential adverse impact is severe, the company should terminate the business relationship in relation with the concerned activities.\textsuperscript{103}

When it comes to actual adverse effects, more or less the same appropriate measures apply but the company must draw up a ‘corrective action plan’ which is developed in consultation with the affected stakeholders.\textsuperscript{104} Companies are also obliged to neutralize the adverse effects or limit their extent, including through the payment of financial compensation, proportionate to the significance and scale of the adverse impact and the contribution of the respective company.\textsuperscript{105}

As regards the enforcement of due diligence obligations, in addition to the complaints procedure that companies must provide,\textsuperscript{106} the CSDD makes use of both public and private enforcement mechanisms. The administrative enforcement provisions oblige Member States to appoint one or more national supervisory authorities to supervise compliance with these obligations.\textsuperscript{107} The EC will also establish a European network of supervisors to promote cooperation and coordination.\textsuperscript{108} National supervisors will be given various powers, including requesting information and carrying out investigations.\textsuperscript{109} Such an investigation may be \textit{ex officio} or in response to substantiated concerns from natural and legal persons.\textsuperscript{110} When a violation is detected, the supervisory authority should – where possible – enable the company to take remedial action within an appropriate period of time.\textsuperscript{111} National supervisors should at least have the powers to (a) order the (permanent) cessation of an infringement and the adoption of corrective measures, (b) impose fines (based on the company’s turn-

\textsuperscript{100} With regard to the contractual assurances of business relationships, the EC will make guidelines with model contracts available. See article 12 CSDD.
\textsuperscript{101} Article 7(5) CSDD.
\textsuperscript{102} Article 7(5)(a) CSDD.
\textsuperscript{103} Article 7(5)(b) CSDD.
\textsuperscript{104} Article 8(3)(b) CSDD.
\textsuperscript{105} Article 8(3)(a) CSDD.
\textsuperscript{106} Article 9 CSDD.
\textsuperscript{107} Article 17(1) CSDD.
\textsuperscript{108} Article 21 CSDD.
\textsuperscript{109} Article 18(1) CSDD.
\textsuperscript{110} Article 18 jo Article 19 CSDD.
\textsuperscript{111} Article 18(4) CSDD.
over\textsuperscript{112}), and (c) take interim measures to avoid (potential) harm.\textsuperscript{113} A further implementation of these powers and sanctions is up to the Member States.\textsuperscript{114}

Article 22 CSDD allows for civil liability. Companies can be held liable for damage if they do not comply with the due diligence obligations under Articles 7 and 8 of the CSDD (with regard to the prevention, limitation and termination of (potential) adverse effects) and damage has been suffered as a result.\textsuperscript{115} How this civil liability is shaped is left to the implementation of the directive into the national laws by the Member States.

2.6. Overview

Based on the descriptions of the national and European corporate sustainability due diligence initiatives Table 1 provides an overview.\textsuperscript{116}

3. Liability for Social Harms

Effective enforcement of substantive law requires that liability should be appropriately allocated.\textsuperscript{117} This also holds for the recently introduced corporate sustainability due diligence initiatives. The key question is whether the CSDD and other due diligence initiatives can indeed provide the right incentives to internalize these social costs in an effective way.\textsuperscript{118}

The adverse impacts for which the CSDD introduces due diligence obligations can be qualified as negative externalities. Because social costs are not borne by companies, they are not taken into account in production decisions, and as a result we see underinvestment in safety measures to prevent these negative impacts. Government intervention can force negative externalities to be internalized in several ways, for example via taxation or the use of liability rules.\textsuperscript{119} But even with liability rules in place, a company’s liability costs can substantially understate the social costs of its business activities because of the principle of limited liability.\textsuperscript{120} The strategic use of limited liability allows parent companies to shift risk disproportionately to under-

\textsuperscript{112} Article 18(5) CSDD.
\textsuperscript{113} Article 20(3) CSDD.
\textsuperscript{114} Article 18 jo 20(1) CSDD.
\textsuperscript{115} Article 22(1) CSDD.
\textsuperscript{116} This overview is based on Table 1 in Anne Lafarre and Sebastiaan Rombouts, Towards Mandatory Human Rights Due Diligence: Assessing Its Impact on Fundamental Labour Standards in Global Value Chains 13 European Journal of Risk Regulation 1-17 (2022).
\textsuperscript{117} Davies (n. 8).
<table>
<thead>
<tr>
<th>Due Diligence initiative</th>
<th>Type of legal instrument</th>
<th>Year</th>
<th>Business relationships</th>
<th>Scope of companies</th>
<th>Enforcement</th>
<th>Adverse impacts covered</th>
</tr>
</thead>
<tbody>
<tr>
<td>UNGPs and OECD Guidelines</td>
<td>Soft law</td>
<td>2011</td>
<td>Entire GVC</td>
<td>All companies, but due diligence in proportion with the company’s size, nature of the enterprise, etc.</td>
<td>No legally binding obligations, but NCPs that handle non-judicial grievance processes.¹</td>
<td>Responsible Business Conduct</td>
</tr>
<tr>
<td>French Vigilance Law</td>
<td>Mandatory law</td>
<td>2017</td>
<td>Subsidiaries, subcontractors or suppliers with who there is an ‘established commercial relationship’</td>
<td>5,000 employees in France or 10,000 employees worldwide. Including direct and indirect subsidiaries.</td>
<td>Private enforcement: injunctions and civil liability for damages</td>
<td>Human rights, fundamental freedoms, health and safety, the environment</td>
</tr>
<tr>
<td>Dutch ‘Wet zorgplicht kinderarbeid’</td>
<td>Mandatory law</td>
<td>2019 (but not into effect yet)</td>
<td>All business operations in the GVC</td>
<td>Supplying goods/services to Dutch end-users. Excluding companies merely involved in transporting the goods.</td>
<td>Public enforcement: complaints procedure, binding orders, administrative fines. For recurring offences: criminal sanctions.</td>
<td>Child labor</td>
</tr>
<tr>
<td>German ‘Sorgfaltspflichtengesetz’</td>
<td>Mandatory law</td>
<td>2021 (takes effect on 1 January 2023)</td>
<td>Direct and indirect suppliers, but systematic due diligence only to direct suppliers</td>
<td>3,000 (2024: 1,000) employees</td>
<td>Public enforcement: including specific measures and administrative fines.</td>
<td>Human rights, environment (to a lesser extent) drawn from international conventions.</td>
</tr>
<tr>
<td>Norwegian Transparency Act</td>
<td>Mandatory law</td>
<td>2021 (takes effect on 1 July 2022)</td>
<td>Supply chain and business partners (same coverage as OECD Guidelines)</td>
<td>Covered by s.1-5 Accounting Act or meet 2/3 criteria: 50 employees (fulltime equivalent) + NOK 70m revenue + NOK 35m balance sheet. Due diligence in proportion with the company’s size, nature of the enterprise, etc.</td>
<td>Public enforcement: including binding orders, enforcement penalties and infringement penalties.</td>
<td>Human rights and decent working conditions. Key conventions are mentioned, secondary legislation can provide further definitions.</td>
</tr>
<tr>
<td>Corporate Sustainability Due Diligence directive proposal</td>
<td>Mandatory law</td>
<td>Ongoing legislative process</td>
<td>‘established business relationship’</td>
<td>Group 1 (500 employees, 150m net turnover), Group 2 (250 employees, 40m net turnover in high impact sectors). Thresholds apply to companies, not to groups.</td>
<td>Public enforcement: including remedial action, binding orders, administrative fines and interim measures. Private enforcement: civil liability for damages.</td>
<td>Human rights and environment in selected international conventions outlined in Annex of the CSDD.</td>
</tr>
</tbody>
</table>

¹ National Contact Points (NCPs) are offices set up by governments that have adhered to the OECD Guidelines. See for more information about NCPs, https://mneguidelines.oecd.org/OECD-Guidelines-for-MNEs-NCP-FAQ.pdf.
capitalized subsidiaries,121 making them “judgment proof”122. There is ample evidence that limited liability is used strategically by companies.123 For instance, in their seminal 1991 paper ‘Toward Unlimited Shareholder Liability for Corporate Torts’, Hansmann and Kraakman refer to an 1991 Harvard Law School research paper that shows that tobacco and other companies publicly acknowledged to use their subsidiaries as a means to evade tort liability.124 The same research highlights the use of downsizing and independent contractors for avoiding liability.125 More recent studies show the strategic use of limited liability as well. For instance, Akey and Appel show that higher thresholds for liability of parent companies lead to more pollution caused by the subsidiaries.126 And, as Friedman (2020) explains in the context of adverse impacts on human rights: “in human rights litigation against corporations, victims frequently allege that host state subsidiaries are undercapitalised”127.

Several legal strategies deal with the adverse effects of limited liability.128 One such ex post technique that is widely discussed among corporate law scholars is corporate veil piercing.129 In short, veil piercing is a technique that puts aside asset partitioning in corporate groups so that the parent company can be held liable for a subsidiary’s wrongdoing. Therefore, veil piercing can be considered a legal strategy that aims to further internalize social costs of corporate activities so that appropriate


122 Steven Shavell, *The Judgment Proof Problem* 6 International Review of Law and Economics 45-58 (1986). Shavell explains the judgment proof problem as follows: “an injurer with assets of $30,000, for example, will treat an accident resulting in liability of $100,000 identically with an accident resulting in liability of only $30,000. Hence, injurers’ expected penalties may be less than the expected losses for which they are liable.” (p. 45).

123 Hansmann and Kraakman (n. 121).

124 Hansmann and Kraakman, p. 1881 (n. 121). The authors quote Phillip Morris that created its holding company “to better insulate each business from obligations and liabilities incurred in unrelated activities”.

125 Hansmann and Kraakman, p. 1881 (n. 121). Hansmann and Kraakman mention the announcement of the Shell Oil Company to employ independent contractors to transport crude oil in order to shield itself from liability claims as a result of oil spills in the wake of the Exxon Valdez oil spill.


127 Friedman, p. 313 (n. 120).


incentives for corporate decision-making are set. 130 Economic theory suggests that tort victims as involuntary creditors in particular cannot protect themselves against corporate wrongdoing ex ante through contract and thus should be protected. 131 However, whereas veil piercing for this group of creditors should be subject to a balancing act between the benefits of limited liability on the one hand and the social costs brought forward by negative externalities on the other, in practice, it turns out to be a complex and criticized doctrine with many comparative differences, associated with open norms that heavily depend on the factual settings of cases and the approaches of courts. 132 For widespread adverse impacts that bring forward substantial social costs, this stands in sharp contrast with the well-known theory of Coase, outlining that a clear division of rights and obligations is important in case of involvement of many parties and high transaction costs. 133 Human rights scholars have argued that veil piercing is not an adequate solution. 134 Veil piercing is difficult because victims not only have to prove that the parent company had a duty of care towards the victims, but also have to establish a causal link between a breach of this duty of care and the damage. 135 Moreover, veil piercing – and similarly, enterprise liability 136 and unlimited liability for shareholders 137 – ignores the strategic use of business relationships outside the classical corporate group structure that use other power relations than equity. 138 Furthermore, depending on the nature of the issue, the laws of the host state

130 Gerner-Beuerle and Schillig (n. 128).
131 Hansmann and Kraakman (n. 121).
132 Gerner-Beuerle and Schillig (n. 128). Also see the references therein about the US doctrine.
134 For instance, Gwynne Skinner argued that “the piercing test does not even take into consideration the unfairness limited liability creates in certain situations, where parent corporations benefit financially at the human rights or environmental expense of an often nonconsenting community” p. 1799. Gwynne Skinner, Rethinking Limited Liability of Parent Corporations for Foreign Subsidiaries Violations of International Human Rights Law 72 Washington and Lee Law Review 1769-1864 (2015).
137 Hansmann and Kraakman, (n. 121). Note that this approach seems to be practical only in case of closely-held companies as shareholders need to be identifiable and their number needs to be limited so that they can be held accountable. See: Nina A. Mendelson, A Control Based Approach to Shareholder Liability for Corporate Torts 102 Columbia Law Review 1203-1303 (2002); Gerner-Beuerle and Schillig (n. 128).
may apply to determine parent company liability.\textsuperscript{139} It is often claimed that host states can have weaker enforcement regimes in place, including weak institutions that suffer from corruption and budget constraints that lead to inadequate probabilities of adverse impacts being detected and sanctioned.\textsuperscript{140} Whereas veil piercing cases may allow victims to bring a suit against a parent company in its home jurisdiction, host states still can have no sufficient regulations in place to prevent harm.\textsuperscript{141}

Mandatory due diligence seems to solve the problem of applicable host state laws\textsuperscript{142} and covers various business relations in the GVC. In addition, this regulatory path avoids that victims are required to prove in court that the parent company has a duty of care vis-à-vis them (and that violation of this duty caused the harm) as the due diligence obligations introduce an independent and statutory duty of care that directly applies to the parent company (and other companies in the GVC).

\section*{4. Effective Enforcement of Liability for Social Harms}

In order to provide the desirable incentives for corporate decision-making, the right actors should be enabled to enforce liability with appropriate sanctions in place.\textsuperscript{143} Selecting the right mechanisms is key to effectively enforce mandatory due diligence. The CSDD and other due diligence initiatives aim at setting \textit{ex ante} incentives for corporate decision-makers to avoid and limit adverse impacts as regards environmental matters and human rights. Only if law enforcement works effectively can the wrongdoer \textit{ex ante} be prevented or deterred from committing such adverse effects, thus \textit{ex ante} influencing the behavior of companies.\textsuperscript{144} However, as Section 2 shows, current regulatory initiatives employ different methods of law enforcement. This may signal that regulators find it difficult to determine the right law enforcement mechanisms to limit adverse corporate behavior.

\begin{itemize}
\item \textsuperscript{139} Following Rome II, articles 4 and 7, The applicable law is determined via the \textit{lex loci damni} principle, i.e. the state where the damage occurs, whereby in the case of environmental damage this can also be determined via the \textit{lex loci acti} principle, i.e. the state where the event causing the damage took place.
\item \textsuperscript{140} Friedman (n. 120); Skinner (n. 134); Cees van Dam, \textit{Tort Law and Human Rights: Brothers in Arms—On the Role of Tort Law in the Area of Business and Human Rights} 221 Journal of European Tort Law (2011).
\item \textsuperscript{141} As Skinner explains, “the problem is that this is often not the case in many countries where foreign-owned subsidiaries operate (host countries), which are often developing countries seeking to attract transnational business” and “as a result of globalization, many have done away with regulations they used to have in order to attract transnational business.” Skinner, p. 1800-1801 (n. 134) and the references therein.
\item \textsuperscript{142} Friedman (n. 120).
\item \textsuperscript{143} Davies (n. 8).
\end{itemize}
It is widely accepted in the legal and economics literature (including the seminal works of *inter alia* Steven Shavell, Gary Becker and Richard Posner\(^{145}\)) that there are different ways to control harmful behavior and that different factors determine what would be an effective law enforcement strategy under certain circumstances. In this section, we will therefore first discuss various of these factors in order to establish a (non-exhaustive) framework for effective law enforcement based on existing literature (Sections 4.1-4.4).\(^{146}\) We then apply this framework to corporate sustainability due diligence in Section 4.5.

### 4.1. Stage of Legal Intervention

As regards the first factor, the *stage of the legal intervention*, Shavell uses three categories. The timing of legal intervention can take place at the earliest stage, thus before an act is committed, aiming at *prevention* of an act.\(^{147}\) Next, the timing can also be after the act has been committed but before (potential) harm occurs, in this case we have ‘act-based intervention’ using ‘act-based sanctions’. Wrongdoers are liable when they perform – or fail to perform – an act, regardless of whether harm has been caused.\(^{148}\) Finally, legal intervention can take place after harm has occurred, ‘harm-based intervention’, of which tort law is the seminal example. Note that harm-based sanctions can, like act-based sanctions, be used to *deter* socially undesirable behavior. Ideally, actual enforcement actions are not that often carried out because these sanctions offer real threat to committing legal violations in the first place.\(^{149}\)

What would be the optimal stage of legal intervention? Existing literature outlines several determinants, including the magnitude of sanctions. Act-based sanctions are typically effective at lower levels than harm-based sanctions because the probability of the act actually causing harm is irrelevant.\(^{150}\) Similarly, the probability of prevention and the application of sanctions plays a role. Particularly, if it is difficult to signal potential undesirable social behavior before an act is committed, prevention will not be the most effective option. In such cases, when acts are sufficiently observable, act-based intervention can be preferable as this allows for imposing sanctions *ex ante*.


\(^{146}\) Our framework is largely based on the well-known 1993 article by Shavell, *The Optimal Structure of Law Enforcement*, (n. 145).

\(^{147}\) For instance when a license to operate a particular business activity is denied.

\(^{148}\) Friedman (n. 120).

\(^{149}\) Faure and Weber (n. 144).

\(^{150}\) Also see Friedman (n. 120).
thus before harm occurs.\textsuperscript{151} In other situations, it can be harder to use act-based or harm-based interventions, making prevention the desirable legal strategy. For instance, in some situations, companies may be effectively prevented from dumping toxic materials in public waters with a fence, whereas dumping toxic materials as an act may be hard to discover, the large-scale damage of dumping may take years to manifest itself and moreover, it may be hard to identify who dumped these materials.\textsuperscript{152} Information plays a role too: actual harm can signal about the dangerousness of the act, whereas act-based sanctions can be informationally more demanding.\textsuperscript{153} Parties should be also informed about the dangerousness of their acts. If they do not have knowledge about the (potential) harm their acts can cause, they may be unaware that committing a particular act could result in sanctions and thus may not be effectively deterred. In these situations, prevention is more effective, but only under the condition that the State has superior knowledge about the risks.\textsuperscript{154}

Why don’t we always use prevention so that a harmful act and, more importantly, harm, never occur? Prevention can be cheap or costly and practical or impractical, depending on the circumstances (a simple fence versus hiring guards to patrol the public waters in order to prevent dumping of toxic materials). Also note that harm-based sanctions can be cheaper as they would occur less often.

4.2. The Form of Sanctions

With the second factor, the form of sanctions, we can distinguish between monetary and non-monetary sanctions, with imprisonment the most well-known form of a non-monetary sanction. As the social costs for imprisonment are much higher than the use of monetary sanctions, monetary sanctions are most desirable under the condition that they can lead to deterrence.\textsuperscript{155} Relevant determinants for monetary sanctions to be effective include the level of wealth of a person (also see the judgment proof problem outlined in Section 3), the private benefits from committing socially undesirable behavior, and the probability that sanctions will be imposed. When the expected social harm of an act is significantly large and monetary sanctions are not sufficiently adequate for deterrence, it can be optimal from a social perspective to use (costly) imprisonment. In terms of civil and administrative sanctions, one can consider injunctions, specific measures and binding orders (for instance revoking a business license or the exclusion from taking part in public procurement procedures) examples of non-monetary sanctions that do not suffer from the judgment-proof problem.\textsuperscript{156}

\textsuperscript{151} Friedman (n. 120).
\textsuperscript{152} Shavell (n. 145). Consider, for example, the years of PFAS discharges from the chemical group 3M, which only came to light during the work on the Oosterweel connection in Antwerp. Financieele Dagblad, Chemiereus 3M zegt miljoenen toe voor sanering vervuilde Vlaamse grond (6 July 2022).
\textsuperscript{153} Friedman (n. 120).
\textsuperscript{154} Shavell (n. 145).
\textsuperscript{155} Becker (n. 145).
\textsuperscript{156} Faure and Weber (n. 144).
4.3. Private versus Public Enforcement

Appropriate actors should play a role in enforcement. These can be private parties in private enforcement, or public authorities, also including prosecutors and the police. In order to rely on private enforcement, private parties should naturally have information about the act and identity of the wrongdoer, and, moreover, should have appropriate incentives to make a public authority aware of their knowledge. Oftentimes, it is too costly or even impossible for private parties to identify the wrongdoer or to have information about the act, whereas public authorities have more powers, including access to monitoring mechanisms, request information, and can benefit from economies of scale in discovering acts and identifying wrongdoers. In addition, public authorities often have the ability to cooperate with other authorities.

As regards the victims’ willingness to report their knowledge about wrongdoers and harmful acts and initiate claims, factors include financial gains from reporting, the desire of private parties to avoid suffering harm, and the retributive motive as factors contributing to reporting. Relevant here is the rational apathy problem; an individual will not report or initiate legal enforcement when the costs outweigh the benefits of doing so. Related to this is the free-rider problem; when there are many victims suffer from socially undesirable behavior, as soon as one victim reports and/or initiate a claim, the others can benefit as well and thus are able to free-ride on the efforts of this individual. This free-rider problem may result in a sub-optimal amount of the ‘public good’; due to private parties being inactive, the actual level of law enforcement is lower than the level of law enforcement that maximizes the collective welfare. Hence, when losses are too small or damages are too scattered, private enforcement may not be optimal. Usually public authorities do not suffer these economic problems as they are required to act in the public interest. One may argue that these problems with private enforcement, however, can, at least partly, be solved by collective actions. Another option is to lower the costs of reporting or initiating legal enforcement for an individual by addressing existing legal hurdles that make access to justice difficult, for instance via ADR.

To conclude, whereas private enforcement can be much cheaper when individuals naturally have information and the right incentives, in many situations there will be (economic) problems that lower the effectiveness of private enforcement, for instance when there are many victims and scattered damages. Moreover, socially undesirable acts may only become visible when substantial harm has occurred.

157 Shavell (n. 145).
158 Shavell (n. 145).
159 Shavell (n. 145).
160 Faure and Weber (n. 144).
161 Faure and Weber (n. 144).
162 Faure and Weber (n. 144).
163 Faure and Weber (n. 144).
4.4. Other Economic Factors

Shavell’s framework shows a variety of economic factors that determine the effectiveness of different law enforcement mechanisms. The law and economics literature has also considered some other factors that are closely related. For instance, we can consider judicial error as a source of social costs, which can be understood as mistaken imposition of liability or the mistaken failure to impose liability, also called ‘error costs’. Error costs depend on the capacity and expertise of the actors that play a role in enforcement – the public authority in particular – and the complexity of the issues. In addition to error costs, there are also ‘direct costs’ to operate the legal process, including the time of lawyers, judges and other actors involved. According to Posner, the economic goal is to find the law enforcement mechanism that minimizes the sum of error and direct costs.

4.5. Effective Enforcement of Due Diligence Obligations

The brief discussion of the law and economics literature about effective law enforcement mechanisms to control harmful behavior already provides some useful insights into how best to design mandatory due diligence enforcement. However, one precondition should be clearly recognized: in contrast to for instance consumer and investor protection matters, severe human rights abuses and widespread environmental damage constitute moral harmful behavior of a kind that should not be handled in a utilitarian way, but on the premise that the optimal occurrence of these severe harms should be zero. This means that proactive prevention should be the desirable stage of legal intervention. When this is not practical, act-based intervention is the next best alternative, instead of deferring legal intervention until social harm actually occurs.

The several measures that due diligence requires – including integrating due diligence into corporate policies and management systems, to undertake due diligence by identifying actual or potential adverse impacts, ceasing, preventing or mitigating them and to enable remediation, tracking implementation and results, and communicating how impacts are addressed – would make harmful acts sufficiently observable for act-based intervention. Moreover, the preventative, risk-based and dynamic characteristics of due diligence can allow potential undesirable behavior to be identified before an act is committed. It is therefore strongly recommended that the

164 Posner (n. 145).
165 Faure and Weber (n. 144).
166 Posner (n. 145).
167 Posner (n. 145).
168 Faure and Weber (n. 144).
169 Friedman (n. 120).
170 Friedman, p. 317 (n. 120).
171 OECD Guidance, p. 21 (n. 52).
172 OECD Guidance, p. 16-17 (n. 52).
European legislator takes the example of the Norwegian Law and follows the international due diligence framework as closely as possible.\(^\text{173}\)

What is the appropriate actor to be involved in the enforcement of due diligence obligations? A proper functioning civil liability system, in contrast to public enforcement with fines, leads to compensation for victims.\(^\text{174}\) There is room for individual private enforcement of due diligence obligations when individual victim’s losses are large and information is naturally available. Yet, social harm often results in situations with many victims and widespread losses. In classical tort law, there is the presumption that victims usually know the identity of the wrongdoers. This can be problematic in the context of due diligence, as it can be difficult for individuals in host states to monitor companies and find out about (potential) harmful acts. Harmful acts may only come to light after they have resulted in substantial damage, which makes civil liability less suitable for due diligence that aims at \textit{ex ante} intervention.\(^\text{175}\) The right to information upon written request for any person in the Norwegian Law can play a role here. The economic problems resulting from these circumstances can also be (partly) solved by allowing for collective actions that increase access to justice, where civil society organizations that monitor corporate behavior based on the controls that due diligence provides, can take part in complaints procedures and are authorized to file for injunctions to stop harmful acts. Whereas for instance the German Law explicitly provides the option for collective action as regards enforcement of the due diligence obligations, article 22 of the CSDD leaves the implementation of the civil liability rules to the Member States, and thus the CSDD does not provide any actual guarantees that these access to justice barriers will be solved.\(^\text{176}\)

To conclude, in cases of widespread harm it is wise to not rely on private parties only; \textit{ex ante} monitoring by a powerful public authority in the home state makes it possible to discover and remedy non-compliance with due diligence that are not discovered by private organizations.\(^\text{177}\) As the findings about the French vigilance plans signal, private actors may not have sufficient means to enforce the required information provision and compliance levels. Therefore, complementarity of public and private enforcement is preferred, with private enforcement being an added value under the condition that barriers to justice faced by private parties are reduced. All due diligence initiatives, except for the French Law,\(^\text{178}\) provide various powers for public authorities to enforce compliance. However, whereas the CSDD, the German Law

---

173 This approach is followed by the Presidency Comprise of the Council of the European Union, \textit{inter alia} by inserting the article 6a ‘Prioritisation of identified actual and potential adverse impacts’. Presidency Comprise of the Council of the European Union, p. 38 (n. 1).
174 Faure and Weber (n. 144).
175 OECD Guidance, p. 16 (n. 52).
176 The Presidency Comprise of the Council of the European Union states that further analysis and discussions are needed as regards this provision, \textit{inter alia} regarding its relationship with the national laws. Presidency Comprise of the Council of the European Union, p. 52 (n. 1).
177 Also article 21 CSDD that provides for the installment of a European network of supervisory authorities contributes to the ability and powers of public authorities in enforcing due diligence obligations.
178 Savourey and Brabant (n. 10).
and the Norwegian Law make it possible for public authorities to start investigations *ex officio* or in response to submitted complaints by individuals, the Dutch Law seems to suggest that public enforcement will need to be initiated by a complaint from an individual, potentially leading to similar economic problems as with private enforcement. Finally, note that, when civil enforcement is not sufficiently effective, public enforcement should be able to provide victims with appropriate compensation in those cases that harm has occurred.

What would be the optimal form of sanctions? Monetary sanctions are generally understood to be most desirable, under the condition that they can be sufficiently deterrent, as non-monetary sanctions can be very costly to society. As we have seen in Section 3, due diligence obligations address the adverse effects of limited liability, including the judgment proof problem, because sanctions can be imposed on parent companies with deep pockets. However, in the context of due diligence, non-monetary sanctions, including specific measures and binding orders (government authorities) and injunctions (private parties) that provide actors involved in enforcement with means to immediately stop harmful acts, should not be missing. The criminal sanctions in case of recidivism are unique in the Dutch Law. Whereas the high sanctions available in criminal law can boost deterrence, criminal law is generally more costly, and as long as administrative and civil law can deliver the desired results, it is probably not necessary for the European legislator to follow the Dutch approach.

Finally, we should address enforcement costs in the context of due diligence. The numerous responses to the CSDD display that various parties call for a harder, more far-reaching approach, whereas others argue for less stringent provisions. The latter group has, among other things, expressed the concern that the due diligence obligations would be too burdensome for – particularly, smaller – companies and that there are costly uncertainties involved in terms of liability. The former group, however, argues that the exclusion of SMEs from the CSDD makes it less effective as severe human rights and environmental adverse impacts often happen further up the

---

179 Enneking, p. 121 (n. 67).

180 Remediation in the due diligence framework refers to selecting the type(s) of remedy that is appropriate in a particular case, including, for instance, providing apologies, restitution, rehabilitation and financial and non-financial compensation. OECD Guidance, p. 34 (n. 52). Article 8(3)(a) CSDD also refers to “the payment of damages to the affected persons” and “financial compensation to the affected communities”.

181 Becker (n. 145). In the context of environmental damage, one may also refer to Kathleen Segerson and Tom Tietenberg, *The Structure of Penalties in Environmental Enforcement: an Economic Analysis* 23 Journal of Environmental Economics and Management 179-200 (1992). The authors show that under some circumstances, imprisonment can be more effective.

182 However, severe recidivism behavior can indicate that civil and administrative law enforcement strategies are insufficient. In these cases there can be merits to explore criminal law sanctions for companies and corporate officers. Also see Friedman (n. 120).

ANNE LAFARRE

GVC.\textsuperscript{184} Here, it is recommended for the European legislator to take the broader scope of the Norwegian Law that, in line with the international due diligence framework, makes explicit that due diligence shall be carried out regularly and in proportion to the size of the company, the nature of the company, the context of its operations, and the severity and probability of adverse impacts on fundamental human rights and decent working conditions. Moreover, the large emphasis on contractual assurances in the CSDD can lead to a box-ticking approach that may provide the wrong impression about \textit{actual} due diligence compliance,\textsuperscript{185} limiting the observability of harmful acts and thus the effectiveness of due diligence. These concerns all seem to relate to Posner’s judicial error costs,\textsuperscript{186} namely the mistaken imposition of legal liability – or, by extension, costly obligations for SMEs that do not bring sufficient social benefits – or the mistaken failure to impose liability. Using mandatory and meaningful due diligence obligations as part of the ‘smart mix’\textsuperscript{187} of measures – so that liability for severe adverse impacts is effectively imposed on the one hand, and the characteristics of due diligence (including the dynamic learning process involving both companies and stakeholders) are explicitly embraced on the other hand – should help to minimize error costs.

5. Concluding Remarks

In this article we considered several binding regulatory initiatives that were recently introduced in ‘home states’ to increase corporate liability for adverse impacts in global value chains (GVCs). These initiatives have resulted in a patchwork of national requirements, particularly regarding the consequences of non-compliance and enforcement. The CSDD should solve the high need for harmonisation of mandatory due diligence obligations, but in order to be able to set appropriate \textit{ex ante} incentives for corporate decision-makers to avoid and limit adverse impacts as regards human rights and environmental matters, selecting the right enforcement mechanisms is a necessary precondition. The articles shows that there are some important mismatches between the CSDD and the factors determined in current law and economics research

\textsuperscript{184} For example, Shift, \textit{Shift’s Analysis of the EU Commission’s Proposal for a Corporate Sustainability Due Diligence Directive} (March 2022). Available at: https://shiftproject.org/resource/eu-csdd-proposal/shifts-analysis/.

\textsuperscript{185} Anne Lafarre, \textit{Mandatory Corporate Sustainability Due Diligence in Europe: The Way Forward}, ECGI Blog (12 April 2022), https://ecgi.global/blog/mandatory-corporate-sustainability-due-diligence-europe-way-forward. It is noteworthy that, where an undertaking negotiates contractual assurances from a direct business partner with whom an established business relationship exists, there is in principle no liability under article 22 CSDD, unless it was unreasonable to expect that these measures would be sufficient. This provision appears to be contrary to UNGP 17, which excludes such safe havens. In its adjustments to this article, the Presidency of the Council stresses the need for further discussions and analyses regarding the use of contractual clauses and the relationship of article 22 with national laws, (n. 1).

\textsuperscript{186} Posner (n. 145).

\textsuperscript{187} UNGPs, p.5 (n. 7).
that determine effective enforcement. The analysis shows that public enforcement with the involvement of public authorities that have strong monitoring and sanctioning powers is key to effectively enforce substantive due diligence obligations. Private enforcement can be of added value provided that current economic problems related to access to justice are addressed in the CSDD.