SUBCONTRACTING AND SOCIAL LIABILITY

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POLICY RECOMMENDATIONS FOR TACKLING ABUSIVE SUBCONTRACTING

To secure workers' rights in supply chains, the ETUC is calling for a general legal framework on subcontracting, with a view to strengthening liability and transparency, and to ensure equal treatment, decent work and effective enforcement throughout the chain.

An EU legal framework on subcontracting should comprise, in particular:

MEASURES FOR ENHANCED LIABILITY

- mandatory joint and several full chain liability of contractors should strengthen compliance with legal obligations and labour standards, including applicable collective agreements;
- such liability schemes should cover both domestic and cross-border subcontracting situations, including in the context of public procurement;

PRACTICES FOR ENSURING DECENT WORK

- workers' rights to information, consultation and participation at board-level should be guaranteed as a means for strengthening workers' influence on corporate behaviour;
- alert systems, control and audit measures and compliance monitoring procedures, such as e.g. codes of conduct or international framework agreements need to be established in collaboration with workers' representatives and trade unions;
- subcontracting arrangements to circumvent collective agreements or opt for less favourable ones in the same sector of activity must be tackled. Collective bargaining and applicable collective agreements must be enforced throughout the subcontracting chain.
- the principle of equal treatment and its practical implementation in terms of equal pay for equal work in the same place should be ensured, independently of where the workers come from or how they are contracted;

STANDARDS FOR INCREASED TRANSPARENCY

- a limitation of the number of subcontracting levels and a prohibition of further subcontracting as soon as labour-only subcontracting enters into a chain should be introduced;
- mandatory non-financial reporting initiatives should be made more effective through the formulation of more precise and binding indicators, asking to 'comply *and* explain' instead of to 'comply *or* explain';
- a binding duty of investigation and verification by the main contractor or leading undertaking of the genuine activity of the subcontractor, its social record and compliance with applicable regulation should be established;

TOOLS FOR EFFECTIVE ENFORCEMENT AND ACCESS TO JUSTICE

- solvency guarantees that secure the payment of wages, social security payments and other social obligations must be (re)installed;
- accessible mechanisms for legal redress and recovery should be available for all workers and their representatives to report abuses and enforce their rights;
- dissuasive and effective sanctions and compensations including back payments in case of non-respect of the applicable legislation and/or collective agreements.

INTRODUCTION

This report fits in an ETUC-project on 'Securing Workers Rights in subcontracting chains' as a second stage of research and analysis. The objective of the project is to build a case for a consistent EU approach towards subcontracting and to help create better tools and conditions (a more adequate legal framework) for workers' representatives to know about their rights and to be informed and consulted about the practices of their company along its subcontracting chain. The first phase of the project was dedicated to several case studies. This second phase consists of an analysis of the existing legal framework, with different angles to be studied and information gathered on subcontracting aspects, such as due diligence, transparency and reporting requirements, joint & several liability, and different legal personalities treated as a single economic and social entity.

A subcontract is defined as a commercial contract (for the provision) of services or a commercial contract (for the provision) of labour, works and materials between a main contractor and a providing or supplying contractor. The parties to the subcontract can be designated, on the one hand, by the term 'main contractor' or 'user undertaking' (sometimes also by the terms 'principal', 'client undertaking' or 'purchaser') and, on the other hand, by the term 'supplier' or 'subcontractor'. Hereafter, we use the terms main contractor and subcontractor.

Important in this second phase is the mapping and clarification of the applicable legal framework. The main task was to analyse the existing legal frame (and its practical functioning) at international, EU and national level, identifying loopholes and contradictions. The analysis also covers legislative and non-legislative tools and practices in the framework of corporate social responsibility. The screening of the legal and regulatory framework had to identify existing provisions on subcontracting, and should lead to an overview of relevant international and national instruments dealing with subcontracting chains, including at UN, ILO and OECD levels. The scheme below summarises these aspects.

Subcontracting - Starting point for an analysis of the regulatory frame

	A. INTERNATIONAL STANDARDS	B. EU DIRECTIVES OR REGULATIONS	C. NATIONAL PROVISIONS
Regulation of subcontracting (if any)			
Due diligence			
Joint & several liability			
Transparency and reporting			

The next sections will deal with the four items identified in this scheme, followed by a section with some basic observations and a concluding section. Each section introduces the item briefly from a legal perspective, followed by a reflection on what is in it for workers' reps in relation to labour rights and labour standards. Each section looks at the levels listed in the scheme (international, EU, national) but, given the research task, the main focus will be on binding legal provisions. Moreover, the national analysis is dedicated to some prominent examples.[1]

1 The research during the second stage was limited to a legal analysis. Our principal point of reference is the attention paid to workers' rights in situations of subcontracting as enshrined in binding regular frameworks and legal provisions.

Subcontracting – from a genuine division to the 'fissured workplace'

1

1.1 SUBCONTRACTING, OUTSOURCING AND EXTERNALISATION OF THE WORKFORCE

In the last decades, many labour-intensive industries went through a stage that can be characterised by a process of outsourcing and externalisation of activities (Weil 2014). Through subcontracting, the production process takes the form of a fragmented multiple chain of activities that is at the same time a value chain. The application of subcontracting in a chain of production or services can be motivated by different arguments: a search for specialism and knowhow not available in-company, the sourcing of specific tasks that do not belong to the core activity, efficiency seeking, a (traditionally grown) division of labour, with long-standing partnerships based on mutual trust, routine or historical arrangements. In genuine cases, a chain is based on, or results in stable relationships between a main contractor who 'delegates' part of the work to specialised and preferred subcontractors. Accordingly, activities, carried out simultaneously or in different parts of (sometimes long) subsequent production chains, are executed by various contractors or subcontractors. The chain forms a hierarchical socio-economic dependency network or triangle, based on intertwined series of (commercial) contracts. The chain constitutes a logistical chain (both horizontal and vertical), as well as a value-chain of an economic and productive nature. Single specialities or parts of a production process are outsourced to external legal entities, often small firms or even self-employed.

However, subcontracting and outsourcing to *de jure* independent entities does not lead to de facto independency. The main undertaking dictates and manages the process. The subcontractor undertakes to perform a specific activity in exchange for an agreed price. Companies at lower levels in the value chain, with the exception of specialised subcontractors with high tech or activities of high added value, are often not in a position to act on equal footing with the main undertaking and sometimes have to deal with abnormally low contracts for the delivery of their products or services. Since the 1980s, traditional subcontracting, through a stable and cooperative division of labour in the production process, altered to a type of outsourcing that was much more cost driven and companies replaced direct employees with all kinds of 'new' employment relations. Work has been handed over to external 'third' parties and executed by 'employers' pretending to belong to other branches, by specialised subcontractors, temporary work agencies, labour-only subcontractors and/or self-employed. As a result, the post-war model of undertakings with skilled and unskilled workers contributing their labour under the supervision and authority of one liable and responsible employer is no longer the standard model. The possibility to outsource parts of the production process and the intensification of subcontracting, driven by a strategy to reduce costs and to avoid direct employment of workers, created a playground for all kind of (commercial) contracts for 'supplying' parts of the production that do not fit in the classical model (Cremers 2009).

The dependency in the chain can have serious drawbacks. On top of the triangle, there are the often long established and completely legal undertakings. Unequal bargaining power in the chain can lead to questionable commercial contracts that define the market transactions between the different levels, with abnormally low-priced outsourcing and tendering. A cost driven chain can easily end up in the informal economy, especially when large settled companies transfer the recruitment of the labour force to labour-only subcontractors that multiply this transmission and drive it even further down by the use of temporary work agencies, gangmasters and other intermediaries (Cremers 2009). The pursuit of the lowest nominal costs of production undermines investment in technology and training, and improvements in productivity and quality. In this process, workers are seriously at risk of a partial or complete non-compliance with mandatory labour standards that are based on equal pay and other equal treatment principles, resulting in a denial of social rights and non-access to HR-services, absence of training facilities, and social and cultural exclusion. Crucial social risks are transferred away from the main contractor to SMEs and/or individual workers. The lower segment is than an irregular supply of cheap labour, resulting in low pay, poor working conditions, inadequate occupational health and safety, a lack of corporate responsibility, substantial distortion of the labour market and sometimes even 'modern slavery'.

1.2 REGULATION OF SUBCONTRACTING

The starting point for the provision of services or products is a contract under which a person or an undertaking known as the 'main contractor' undertakes to perform a specific project for another person known as the 'client' who pays him/her a price for it, without there being any employment relationship between them. A subcontractor is, in legal terms, a firm that concludes with such a main undertaking a contract for the delivery of (parts of) the service or the product. Such subcontracts for services, supplies or works, may also be concluded between the subcontractor and subsequent subcontractors (including self-employed), resulting in a longer value chain. The relationship between the main undertaking and the (subsequent) subcontracting entities is based on a commercial contract, not on an employment contract. A contract for the delivery of services or products does not necessarily makes the main undertaking or the subcontractor mutually liable for the different aspects of non-genuine activities, on the contrary. In fact, this can vary (towards customers, clients or workers) depending on the arrangement between the contracting partners. In most legislation in force, the subcontracting entity is the employer of its workers involved in carrying out the services and as such responsible for any breach of workers' rights. A clear exception in this area is the application of OHS-regulations in the EU. In case a worker employed by a subcontractor performs activities on a workplace of the main undertaking, responsibility for some aspects of the occupational health and safety are shared.[2] It is interesting to consider whether there is any comparable remedy enshrined in the national or EU-legislation to tackle potential negative effects related to the non-respect of other labour standards and/or breaches of labour law.

Although the European Commission has dealt with the issue over a long period of time, there is no direct legislation developed that deals with subcontracting as a market phenomenon with a social impact or with subcontractors as legal entities bound by specific rules or conditions in the social field. In an early European Commission notice, subcontracting is defined as a situation whereby one undertaking, called 'the contractor', whether or not in consequence of a prior order from a third party, entrusts to another, called 'the subcontractor', the manufacture of goods, the supply of services or the performance of work under the contractor's instructions (European Commission 1978).

In 1998, the European Commission published a vast guide (*Law of industrial subcontracting in the European Community: a practical guide*) that provides an overview of relevant aspects of subcontracting in the Member States at that time. The title of the guide is somehow misleading as there is, next to the regulation of general conditions of commercial contracts and some bits and pieces concerning liability for defective products, no law on industrial subcontracting at the level of the European Union. The guide fits in the mainstream EU-policy of the promotion of competition and was and is published by DG Internal Market with the aim to facilitate the improvement of contractual relationships between main contractors and subcontractors, in particular when these relationships have transnational aspects.[3]

2 The 1989 EU Framework Directive for safety and health at the workplace (89/391/EEC) prescribes that an 'employer shall take appropriate measures so that employers of workers from any outside undertakings and/or establishments engaged in work in his undertaking and/or establishment receive, in accordance with national laws and/or practices, adequate information' concerning health and safety risks and the measures taken (Article 10). This was implemented in sector-specific Directives. The 1991 EU Directive on temporary agencies (91/383/EEC) adds that 'without prejudice to the responsibility of the temporary employment business as laid down in national legislation, the user-undertaking and/or establishment is/are responsible, for the duration of the assignment, for the conditions governing performance of the work' (Article 8). The EU Directive on the implementation of minimum safety and health requirements at temporary or mobile construction sites (92/57/EEC) adds an important provision and introduces mandatory coordination between the various parties in a chain, including self-employed on site (from the project preparation stage to the completion of a work).

3 https://ec.europa.eu/growth/content/law-industrial-subcontracting-european-community-practical-guide-rev-ed-0_en

The 1998 guide presents a glossary and a comparative approach of the legal systems governing subcontracting relationships in each of the Member States of the European Community back then. Its content covers the legal description of subcontracting, the determination of the applicable law and of the competent jurisdiction, the binding effect of preliminary negotiations and the rights and obligation of the signatories and other issues related to the contract. It defines subcontracting as a transaction by which one enterprise, called the 'subcontractor', is commissioned by another enterprise, called the 'main contractor', to provide the latter with goods or services that the main contractor will use for own commercial purposes, often, but not always, by incorporating these goods or services into a whole. In this commercial transaction, there is no employment relationship between the signatures.[4]

Two chapters of the 1998 comparative guide provide possible relationships with labour issues that can be elaborated further. A first link comes out of the section that distinguish a contract for the delivery of services from an employment contract, a second relationship can be situated in the liability sections.

a. With some exceptions, industrial subcontracts are not subject to specific regulations of employment issues

A majority of the Member States has no specific provisions on industrial subcontracting, with the result that the subject is classified in accordance with the regulations on commercial relations as laid down in the national Civil Codes. Most often, such legal provisions on subcontracting do not provide clear criteria for the demarcation between a subcontract and an employment contract (or in the British common law vocabulary: a contract 'for services' versus a contract 'of services'). The 1998 guide mentions only a few countries, where the demarcation with employment contracts is explicitly introduced in the regulation of subcontracts. For instance, in Finland, the subcontract will be described as a contract of employment if a subcontractor works for an employer in circumstances characteristic of a contract of employment. In this case, the rules of the contract of employment will apply (wages, working conditions et cetera) even if the parties have agreed to waive them. In the meantime, the courts in most other EU countries take such a 'substance over form' or 'primacy of the facts' approach as well.[5] This means that the courts can reclassify a contract, which according to the wordings (stipulating the parties' intentions) was labelled as a subcontract, if the execution of that contract in practice shows that ('taking all circumstances into account') it is in reality rather a contract of employment. Whether or not the person who agrees to carry out work for another person against payment, works in reality in subordination or can genuinely independently decide how, when and where to work him/herself, is the key indicator in misclassification court suits.[6]

Important from the perspective of this study is that the reclassification 'risk' is only substantial in (sub)contractual relations with (bogus) self-employed contractual counterparts. In particular, it may have deterrent impact on the stronger contractors in the chain if these entities have direct (sub)contracting relationships with many (bogus) independent contractors. In contrast, courts operate very cautiously in cases where it is claimed that the corporate personality of a (sub)contracting company is being used as a mask by the other contracting party to escape employer responsibilities. Usually, beyond-every-possible-doubt proof must be provided before a court would decide that another party in the chain than the formal employer is the 'real' employer. Hence, it is very difficult to 'pierce the corporate veil' and successfully challenge before the court so-called letterbox companies who act as the formal employer while in reality the employees work under supervision of the contractual counterpart (the user undertaking).

b. In general terms clauses excluding liability can be considered valid in so far as they are not contrary to public policy

The 1998 overview reveals that in relation to the exemption from liability or clauses excluding liability, there is reference to good morals and incompatibility with public policy, mandatory rules and fundamental principles of law. However, in most countries this is not further specified in the national regulations. The main items in this regard are liability for the design, the performance, the quality or (hidden) defects. Contractual liability involves in these situations the obligation on a contracting party who fails to fulfil all or part of the obliga-

4 Interestingly, the guide makes a distinction between different types of subcontracting agreements (related to products, services and equipment). Labour-only subcontracting is not mentioned in the guide.

5 However, in Poland, the description of the status as worker or self-employed is subject to the will of the parties.

6 In relation to gig work via app, there have recently been some landmark judgments from the Supreme Court of the UK (19 February 2021) and the Superior Court of California (August 10, 2020), reclassifying drivers as being employed by Uber and Lyft instead of collaborating with these platforms as an independent 'partner'.

tions under the contract to make good the damage caused to the other party either by the complete or partial non-performance or by the late performance of the contractual obligations. This includes the subcontractor's liability for damages caused by its employees. Liability provisions related to workers' rights or labour standards are rather rare. Interestingly, the Portuguese regulations specify explicitly that it is prohibited to exclude or restrict in contract clauses, directly or indirectly, liability for injury to the life, mind, body or health of persons. Moreover, it is not possible to exclude or restrict, directly or indirectly, liability for acts of agents and employees in cases of deception, misrepresentation, serious negligence or misconduct.

Since the publication of the 1998 guide, the national regulations of subcontracting have not changed to a significant degree. However, some substantial national initiatives (Spain, Finland, Germany) are explored below. But first, we will have a look at the case law at EU-level. In the frame of the public procurement regulations, a limitation of subcontracting was subject to court deliberations. Overall and over the years, the CJEU has stressed that a prohibition or restriction on subcontracting may be allowed only in situations where the contracting authority has not been in a position to verify the technical and economic capacities of the subcontractors. Thus, if the contracting authority can check the 'technical and economic capacities' of a subcontractor, subcontracting cannot be prohibited or restricted, at least not in the tendering stage. In recent years, the CJEU has reiterated that across-the-board quantitative restrictions of subcontracting is contrary to EU public procurement law.[7]

The CJEU held, in 2016, but still based on the previous Directive 2004/18 in one case (*Wrocław, C-406/14*), that the primary position under the EU procurement regime was that there should be no limitation on subcontracting, except in specific circumstances where the restriction can be justified by a legitimate interest in ensuring the proper execution of the contract. Beforehand, the advocate general had already stated that restrictions on subcontracting defeated one of the purposes of the EU's public procurement Directives, which are 'designed not only to avoid obstacles to freedom to provide services in the aware of public service contracts or public works contracts but also to guarantee the opening up of public procurement to competition'. According to that opinion, possibilities of subcontracting are liable to encourage small and medium-sized undertakings to get involved in the (transnational) public contracts procurement market and should enable such undertakings to participate in tendering procedures and to be awarded public contracts regardless of the size of those contracts.[8]

In a second case with cross-border impact (*Borta UAB, C-298/15*), the CJEU ruled in 2017 that restrictions in the Lithuanian legislation in which a successful tenderer itself was obliged to perform the 'main works' directly, were contrary to the freedom of establishment and the freedom to provide services. Articles 49 and 56 TFEU must be interpreted as precluding such a provision of national law. A prescribed restriction is only justified in so far as it pursues a legitimate objective in the public interest, and to the extent that it complies with the proportionality principle.[9]

Finally, it has to be noted that in the Draft for the revision of the Posting of Workers Directive (hereafter PWD), a provision was included concerning posted workers in subcontracting chains, establishing equal pay between posted workers and workers employed by the main contractor including those standards in company level agreements on a voluntary basis (on a proportionate and non-discriminatory basis). This was deleted from the version finally adopted. It would have required that the same obligations would be imposed also on all national subcontractors. The proposed provision was directly related to the CJEU judgment in *RegioPost C-115/14* on public procurement, after which it became clear that Member States may impose the obligation to respect statutory minimum applicable rates of pay to the tenderers and their subcontractors.

7 Nevertheless, although Directive 2014/24 does not define the term 'subcontracting', article 63(2) of Directive 2014/24 includes a provision that can be seen as allowing a limitation of subcontracting. In the case of 'works contracts, service contracts and siting or installation operations in the context of a supply contract, contracting authorities may require that certain critical tasks be performed directly by the tenderer itself or, where the tender is submitted by a group of economic operators….by a participant in that group'. In this case, the contractor must perform those tasks directly. It is not allowed to subcontract them or to otherwise entrust the tasks to third parties. In the implementing national provisions of some Member States subcontracting is defined. For example, in Poland, a subcontract is defined as a written contract for pecuniary interest having as its subject matter the services, supplies or works that constitute part of the public contract concluded between an economic operator selected by the contracting authority and another entity (subcontractor). Similarly, Italian provisions define subcontracting as a contract according to which a contractor entrusts third parties with the execution of a part of the services or works that are the object of the public contract. National definitions, where used, have common characteristics, in that they either specify or imply that subcontracting may concern only a part or parts of a contract. Sometimes, national legislation specifies a maximum share of the contract that can be subcontracted to third parties, expressed as a percentage of the total value of the procurement contract.

8 http://curia.europa.eu/juris/document/document.jsf;jsessionid=9ea7d2dc30dd449974eab6894bc6be5cb39fda79f4f2.e34KaxiLc3qMb40Rch0SaxuRc3n0?text=&docid=171642&pageIndex=0&doclang=EN&mode=req&dir=&occ=first&part=1&cid=887188

9 http://curia.europa.eu/juris/document/document.jsf?text=&docid=189626&pageIndex=0&doclang=en&mode=req&dir=&occ=first&part=1&cid=705342

1.3 INTERESTING NATIONAL INITIATIVES

The most far-reaching national regulation on subcontracting was concluded in **Spain** in 2006, the very first result of a Popular Legislative Initiative (ILP) dealing with labour issues that was presented to the Spanish Parliament (Muñoz de Bustillo Llorente 2016). In October 2006, the Spanish government approved a law to control subcontracting in the construction sector, mainly motivated by evidence that the use of long subcontracting chains was one of the main causes of high industrial accident rates. The law prescribes that companies must engage a mandatory proportion of direct and permanent employment contract workers (at least 10% of a company's workforce in a period of 18 months after the introduction of the law, increasing to 20% in the next 18 months, and finally ending at 30%). The law stipulates that companies, which plan to subcontract, must register with their business address, have to provide quality and solvency guarantees, and the relationship between the main contractor and the subcontractors has to be written and maintained in a *subcontracting book* at the worksite.

Article 4 of the Spanish law establishes that companies, which want to be contracted or subcontracted for construction works, must be registered in the Registry of Accredited Companies (REA - *Registro de Empresas Acreditadas como Contratistas o Subcontratistas del Sector de la Construcción*). This requirement applies to domestic firms and to cross-border service providers that translocate workers to Spain. Another important provision is the introduction of a restriction to three levels of successive subcontracting for specialised activities and only one level of subcontracting for labour-intensive jobs. The subcontracting chain has to stop whenever reference is made to self-employed or an 'intensive subcontractor', a firm or agency that solely supplies workers (labour-only subcontracting). The third subcontractors (and self-employed workers) will not be entitled to subcontract work that has been contracted to them, neither to another subcontractor firm nor to other self-employed workers (Article 5). Further levels are only acceptable due to technical production complications, for specialised activities in cases of 'force majeure' or in case of prior approval by the architectural supervision team. If the main contractor fails to comply with these legal provisions, subsidiary liability and responsibility is applicable. Liability responsibility is extended to all labour and social security obligations (Article 6.2). For example, the contractor can be held liable in case of non-payment of the social security contributions of the employees of the subcontracted firm.[10]

The law was assessed at EU-level mainly in relation to the functioning of the internal market, as containing 'restrictions' to the freedom to provide services. The justification, namely the protection of workers´ health and security on site, can be classified as a public health justification and that is probably the reason why the law has not been a subject of European infringement procedures. The requirements were clarified by the First Additional Provision of Royal Decree 1109/2007, of 24 August 2007, which states that cross-border providers must be registered in the Register under the labour authority in whose territory they are going to carry out their first Spanish provision of services. This registration is not necessary when the duration of the cross-border service does not exceed eight days.[11]

The law is still in place. However, it is not easy to find hard evidence on the actual functioning. And even more important, the financial crisis, and the following collapse and restructuring of the construction industry, with a proliferation of very small firms out of reach of the traditional mechanisms for enforcing compliance, meant that the legislation had to function in a completely changed environment. The result was a seriously reduced scope of coverage.

In general, the driving forces behind the law, the Spanish trades unions, have the impression that while in big investment projects (with large firms) the level of compliance with the law is reasonable, in the deregulated sector of micro-firms (and informal employment) the level of compliance is poor. An in-depth assessment of the compulsory registration with the *Registro de Empresas Acreditadas* (REA) was published in 2019 (Romero-Barriuso et al. 2019). The analysis reveals that the public bodies in Spain, when acting as contractors in the construction sector, are to a great extent non-compliant with the obligation to register. The registration rates of 13.4% among Public Administrations, Municipal Town and City Councils and Provincial Councils, is in sharp

10 To a certain extent this law is a follow-up of the implementation of the 1992 EU-Directive on temporary and mobile worksites that prescribes coordination and cooperation measures on construction sites. The law (Ley 32/2006 of 18 October 2006) was modified in 2009. The consolidated text can be found on: https://www.boe.es/buscar/pdf/2006/BOE-A-2006-18205-consolidado.pdf
11 https://app.mapfre.com/fundacion/html/revistas/seguridad/n110/articulo2En.html

contrast with the data from the private sector firms where registration stood at over 90%. According to the authors, this permissive attitude of non-compliance with the duty to register with the REA by the Public Administrations engaged in construction activities, as required by law, is a bad example for society. The behaviour of the Public Administrations should be exemplary and a model to follow for others. Interestingly, most private firms opine that the REA functions as a good instrument to control subcontracting in the construction sector and that it has increased the solvency and quality of construction sector firms.

A second interesting legal innovation was adopted in **Finland**, in addition to its Procurement Act.[12] The country adopted the general Act on the Contractor's Obligations and Liability when Work is Contracted Out (1233/2006, hereafter Act on Contractor's Liability) in November 2006 and supplemented the Act in 2012 with enhanced obligations for the construction sector. The Act was amended several times. It applies to all sectors where subcontracting or temporary agency work is utilised. At the time of the introduction, subcontracting was expanding in construction as well as spreading into other sectors. According to the legislator, long subcontracting chains could lead to situations where work was being carried out without withholding employee taxes, making VAT payments, making pension payments or observing conditions laid out in collective bargaining agreements. Therefore, legislation was deemed necessary that places the responsibility on users of subcontractors (both clients and main contractors) to guarantee compliance with legal and other obligations. The basic premise is that a contractor, before entering into an agreement, should ensure that its contracting partners comply with their statutory obligations.[13]

According to the Finnish Act on Contractor's Obligations, a contractor has an obligation to check the background of the contractual parties with whom an agreement involving temporary agency work or specific work based on subcontracting is concluded. Any company acting as contractor in a contractual chain is responsible to require the information mentioned in the Act. The Act on Contractor's Liability is applicable for both domestic and foreign subcontractors and companies using temporary agency workers. Companies that make use of subcontracting or employment agency workers on a large scale, particularly in the construction sector, have to ask for and obtain documents that verify certain registrations and payment of taxes as well as a reference to applicable collective bargaining agreements or similar conditions. Companies have to give extracts of the Trade Register and accounts of whether the firm is entered in the Prepayment Register. Foreign subcontractors must submit information corresponding to the clarifications and certificates of the Act in the form of register extracts as stipulated by the laws of the country of business or similar certificates, or in another generally acceptable manner.

Assessments pinpoint uncertainty of the Act's applicability, easy ways to circumvent the obligations and a lack of dissuasive penalties. The impression is that getting the required information on foreign companies is cumbersome. Contractors mainly criticise the 'administrative burden'. Over the years, several court proceedings had to deal with provisions of the Finnish Act on Contractor's Obligations, for instance when the legal form of a foreign firm corresponds with a limited company, the application in certain sectors, the application of limit values and thresholds, indicators whether information provided by a contracting partner is genuine, the negligence of posting obligations, and the need to assess substance not only on entries in a register, but also on the basis of actual engagement in operations.[14]

On a final note, worth mentioning is a recent legislative initiative in **Germany**, complementing the 2017 Act for Protection of Workers' rights in the Meat Industry (*Gesetz zur Sicherung von Arbeitnehmerrechten in der Fleischwirtschaft: GSA*) which extends joint and several liability of the contractor and the subcontractor for social security contributions to companies in the meat industry (see for more details about the German system of chain liability below under section 3). A recent WSI-report observes that the result of this specific legislation so far has been limited (Erol 2021). Since 2017, the use of (bogus) posted workers dropped, but there is no substantial drop in the number of subcontracted workers (rather a replacement of posted workers by migrant workers employed by German temporary work agencies or subcontractors) or any marked improvement in their conditions.[15]

12 For the latest consolidated English text, see: https://finlex.fi/en/laki/kaannokset/2006/en20061233.pdf and for an explanation in English: https://tyosuojelu.julkaisuverkossa.fi/tilaajavastuulaki_EN/#/article/1/page/1
13 The social partners in construction published a *Guide for employment of foreigners in Finland* (in English) that explains the Act: https://www.rakennusteollisuus.fi/globalassets/tyoelama/tyovoima/guide-for-employment-of-foreigners-2013.pdf#page=1&zoom=auto,-82,554
14 See: https://www.tyosuojelu.fi/web/en/grey-economy/contractor-s-obligations-and-liability
15 For a legal analysis of letterbox-practices with posted workers in the German meat sector, see Houwerzijl 2017.

Repeated outbreaks of COVID-19 renewed public concern about the longstanding labour abuse in the German meat processing branch. This led to the enactment of the Occupational Safety and Health Inspection Act (*Arbeitsschutzkontrollgesetz*) of December 2020, providing for enhanced inspection on health and safety, together with a ban on contract work and stringent restrictions on the use of temporary agency workers in the meat industry. For companies in slaughter, cutting and deboning, with more than 50 employees, a ban on contracts for services (from 1 January 2021) and a ban on temporary agency work (from 1 April 2021) is introduced. For a transitional period of three years, temporary agency work can be used in other parts of the meat processing sector on the preconditions that a collective agreement applies and that agency employees account for at maximum 8 percent of a workplace’s employment, as measured in terms of annual working hours. Moreover, the maximum assignment length for temp agency workers will be 4 months and the same pay and conditions for agency workers and core staff apply from the first day of the assignment. The hope is that allowing temporary agency work only if a collective agreement is concluded, will lead to renewed interest in collective bargaining on the employer’s side. This might contribute to ending the destructive price competition and the cost driven externalisation of the recruitment.

Due diligence

2

2.1 BACKGROUND

Due diligence became common practice (and a common term) in the USA after the adoption of the Securities Act of 1933. It requires a reasonable investigation, audit or review. After the adoption of the Act, securities dealers and brokers became responsible for fully disclosing material information about the instruments they were selling. Failing disclosure of information to potential investors made dealers and brokers liable for prosecution. As long as brokers and dealers exercised ‘due diligence’ or handled with reasonable care, when investigating the companies whose equities they were selling, and fully disclosed the results, they could not be held liable for information that was not discovered during the investigation. Investment analysis focused on value, in the sense of financial performance. In that context, due diligence stood for the verification and investigation of business transactions, such as the evaluation of assets in case of take-overs, and implicated the disclosure of the found information. Among institutional investors and business advisors, the 2005 Freshfields Report is often seen as a turning point as it challenged the then mainstream market orthodoxy that environmental, social and governance (hereafter ESG) criteria and considerations by pension funds and other financial institutions and intermediaries in investment decisions were unlawful or a breach of fiduciary duties. The report explores the association between ESG considerations and investment decision making. It speaks about ‘extra-financial interests of savers in conjunction with their financial interests’ later on defined as certain social and environmental interests that find expression in international treaties, norms, and declarations, particularly those emerging from the democratic deliberative processes of the United Nations (Freshfields Bruckhaus Deringer 2005).[16]

Over the years, the United Nations Environment Programme Finance Initiative (UNEP FI) has been working with the financial services sector and its stakeholders to understand better the two-way interaction between investment and the environmental and social context in which it takes place. The integration of ESG-criteria, including the social and environmental behaviour of companies, was more and more accepted as a valid and relevant consideration for investment. In the slipstream, the use of the term due diligence expanded to a broader practice; it became the investigation or exercise of care that a reasonable business or person is normally expected to take before entering into an agreement or commercial contract with another party. The concept of due diligence introduced by the United Nations Guiding Principles on Business and Human Rights and the ILO Tripartite declaration of principles concerning multinational enterprises and social policy, later on incorporated in the OECD Guidelines for Multinational Enterprises, is the main reference in the current international context. According to these documents due diligence has to ‘identify, prevent, mitigate and account for’ adverse corporate impacts on human rights and the environment, with an extension to other areas of responsible business conduct.

On 25 May 2011, the OECD member countries added another aspect of due diligence as they agreed to revise their guidelines promoting tougher standards of corporate behaviour, including human rights. The 2011 revision

16 The Trump administration formulated in the summer of 2020 a regulation with the aim to restrict the use of ESG considerations in investment decision-making. The text reaffirmed a return to the standard interpretation of fiduciary guidelines that only financial risks and returns should be considered in the management of U.S. employer-provided pension funds. ‘Non-pecuniary goals’, for example relating to political or public policy, should not guide pension investments. The Biden administration has planned to reverse the rule. The US Department of Labor announced on 10 March 2021 that it will not enforce either final rule or otherwise pursue enforcement actions. https://www.dol.gov/sites/dolgov/files/ebsa/laws-and-regulations/laws/erisa/statement-on-enforcement-of-final-rules-on-esg-investments-and-proxy-voting.pdf

led to an extension of the OECD Guidelines, particularly to other areas, such as the environment and climate change, as well as risks related to conflict, corruption, labour rights, disclosure and consumer interests. The new definition required a corporation to investigate third party partners for potential abuse of human rights. According to the OECD Guidelines for Multinational Enterprises all members will 'seek ways to prevent or mitigate adverse human rights impacts that are directly linked to their business operations, products or services by a business relationship, even if they do not contribute to those impacts'.[17]

In a recent OECD publication, an analysis is provided of the application of Responsible Business Conduct objectives (hereafter RBC objectives). The report highlights how OECD members and adherents to OECD instruments (the OECD *Recommendation on Public Procurement and the OECD Guidelines for Multinational Enterprises*) incorporate RBC objectives and risk-based due diligence into their public procurement systems. A key finding is that a majority of the analysed countries promote some environmental objectives through public procurement, but only a few have comprehensive frameworks addressing all RBC objectives throughout the entire supply chain. Over two-thirds of central purchasing bodies verify whether the main contractor complies with environmental, labour rights and integrity-related requirements set in a contract, but do not verify compliance at the subcontractor level to the same extent. In practice, public procurement processes rarely include a consistent due diligence approach. The OECD recommends the adoption of a comprehensive approach to considering RBC objectives in public procurement systems, covering aspects of RBC objectives throughout the entire supply chain and throughout all phases of the public procurement cycle, with special attention given to contractual obligations (OECD 2020).

In this respect, reference can be made also to Article 12.5 of the Enforcement Directive 2014/67, related to the posting of workers, that enables Member States on a voluntary basis to provide for a 'due diligence escape clause', according to which a contractor that has undertaken due diligence obligations as defined by national law shall not be liable. Specific requirements are not defined and are left, according to recital 37, to the discretion of the Member States. They may include, inter alia, measures taken by the contractor concerning documentation of compliance with administrative requirements and control measures in order to ensure effective monitoring of compliance with the applicable rules on the posting of workers.

According to the 2019 European Commission report on application and implementation of Enforcement Directive 2014/67, sixteen Member States introduced the option of a due diligence defence. In eight cases, this took the form of an overall assessment of the contractor's diligence in the individual case (Cyprus, the Czech Republic, Estonia, Greece, Ireland, the Netherlands, Poland and the UK). Twelve Member States (Austria, Belgium, Croatia, the Czech Republic, France, Hungary, Luxembourg, the Netherlands, Poland, Romania, Slovakia and Spain) formulated explicit criteria for the contractor's obligations to control and/or promote compliance by a subcontractor stipulated by law, whereby the degree of detail ranges from a very general indication in Poland to an extensive enumeration of criteria in Croatia. The Italian law provides for due diligence only for the road transport sector (European Commission 2019).

2.2 DEBATES ON THE REGULATORY FRAME

Due diligence can apply as a result of a voluntary action or of a mandatory obligation. Areas of concern continue to develop and cover issues such as finances and the commercial situation of company, international transactions, intellectual, real and personal property, insurance and liability coverage, labour matters, workers' rights and employee benefits, legal and tax issues, environment and sustainability.

Overlooking the literature produced in the last decades, the impression can easily be that there is a spectacular increase of regulation. For instance, the Financial Times stated in May 2020 'Since 2018, there have been over 170 ESG (environmental, social and governance) related regulatory measures proposed globally - that is more than the previous six years combined.' *Datamaran*, a software analytics platform that identifies and monitors external risks, including ESG, estimated in 2018 a 72% increase in ESG regulations and with over 4,000 ESG mandatory and non-mandatory regulatory initiatives.[18] According to other scholars, the pace of regulatory change on ESG - with the EU, UN, OECD and national governments becoming more active - has increased

17 OECD 2011, http://www.oecd.org/dataoecd/43/29/48004323.pdf
18 https://www.datamaran.com/non-financial-reporting-directive/

markedly since then (Parsons 2020). The authors also see an exponential growth in litigation and refer to figures of the *Sabin Center for Climate Change* at Columbia University and the Grantham Research Institute on Climate Change and the Environment at the London School of Economics and Political Science. In the two decades from 1986 to 2006, there had only been a handful of cases worldwide on environmental liability and climate change. However, in the 10 years from 2010 to 2020 there were over 1,000 cases.[19] Cases before the court concern mainly civil law cases often brought against a parent company for harms which took place through the activities of its subsidiary, and raise questions of parent company liability and duty of care. However, one can question whether social considerations play a fundamental role in the ESG-context. This asks for more practice-oriented analyses.

In the European Commission's Action Plan on Financing Sustainable Growth of 8 March 2018 explicit reference is made to methods of developing and disclosing sustainability strategies, including appropriate due diligence throughout the supply chain, and measurable sustainability targets. But there is no further exploration of the social dimension. And although the European Parliament called on the Commission, in its May 2018 Report on Sustainable Finance, to provide a legislative proposal for an overarching, mandatory due diligence framework including a duty of care, this duty is focusing mainly on climate and other environmental risks. In the report, only one sentence is dedicated to minimum standards on ESG risks that should include minimum social standards for investments encompassing workers' rights, health and safety standards. This is in stark contrast to the demand for binding EU-legislation that increases protection for individuals and communities, workers and their representatives, human rights defenders, and the environment, which was formulated in October 2019 by 80 NGOs and trade unions.[20]

In recent years, some scholars have assessed the due diligence practices and examined the impact of the regulatory requirements for the company conduct (own operation and through the chain).[21] Remarkably, the most outspoken conclusion is that because of the existing lack of regulatory or legal requirements to undertake due diligence, regulation is currently the least selected incentive for companies to undertaking due diligence. Other drivers, such as the current corona pandemic, have significant more influence. The rate of companies that, either in the 2020 financial statements or in the 2019 financial statements filed in 2020, mentioned their risk management initiatives, significantly increased.[22] But even then, the wording speaks volumes, with all emphasis on monitoring risks and opportunities, not on compliance with fundamental social rights, such as equal treatment, dignity or fair working conditions.

Good governance has been an object of international debate for years, with developments moving from a soft law approach to the request coming from the corporations of a regulation of their obligations related to human rights. This debate about the regulation of due diligence became topical at EU-level in the spring of 2020 with the announcement of EU Commissioner for Justice Didier Reynders that the Commission wants to introduce rules for mandatory corporate environmental and human rights. A European legal framework was announced for both the due diligence obligation of business to prevent and mitigate business impacts on human rights and environment, and the access to remedy mechanisms allowing the enforceability of the parent company's responsibility to monitor the behaviours of its affiliated companies and supply chain in third countries. The Commissioner presented the findings of the Commission study on options for regulating due diligence requirements, during a high-level online event hosted by the EU Parliament's Responsible Business Conduct Working Group on 29 April 2020. The findings revealed that a majority of stakeholders was of the opinion that the current regimes of voluntary measures have failed to significantly change the way businesses manage their social, environmental and governance impacts. Moreover, the voluntary schemes do not provide remedy to victims. While the transposition of the UN Guiding Principles on Business and Human Rights' standard of due diligence into legal (binding) standards is increasingly being discussed in Member States, only one in three businesses in the EU are currently undertaking due diligence which takes into account all human rights and environmental impacts. A broad coalition of civil society organisations and trade unions strongly supported the release of the findings from this study on due diligence requirements through the supply chain. This coalition stated that the results affirm that voluntary measures are failing. They repeated that there is urgent need for regulatory

19 http://climatecasechart.com/about/

20 https://corporatejustice.org/final_cso_eu_due_diligence_statement_03.10.19-compressed.pdf

21 The European Commission commissioned a study, with country reports, to a consortium (BI-ICL, Civic Consulting and LSE) that was published in January 2020, *Study on due diligence requirements through the supply chain*, Luxembourg. The synthesis report pays little attention to workers' rights; the focus is on environmental and human rights issues. However, in the full report also workers' rights are treated.

22 Datamaran signals after years of focus on the environment, that the pandemic has brought the 'social' aspects related to sustainability to the fore.

action at EU level in order to protect workers, communities, and the environment from systematic, ongoing and worsening human (social) rights and environmental impacts linked to the global supply chains of businesses and financial institutions.

In response, the European Parliament Committee on Legal Affairs prepared a legislative own-initiative report on corporate due diligence and corporate accountability with recommendations to the EU Commission.[23] The report, adopted in March 2021 with a large majority, sends a strong signal of the EP's support for the introduction of mandatory human rights due diligence. In September 2020, the JURI-committee of the European Parliament published the draft with recommendations and a proposal for a Directive aiming at preventing and mitigating adverse effects on human rights, environment, and governance, and to ensure that businesses can be held accountable for these impacts and that anyone who has suffered harm can effectively exercise their right to obtain a remedy. A Directive should cover all undertakings governed by the Law of a Member state or established in its territory, with a harmonised regime of the due diligence obligation extended to subsidiaries and supply chain operating outside the EU. It should comprise a specific penalty system articulated through Member States and an adaptation of the European rules on applicable law and jurisdiction to ensure the applicability of the national laws resulting from the Directive and to overcome the limits of extraterritorial jurisdiction, in claims of human rights violations committed in third countries by businesses.

2.3 THE NATIONAL OUTLOOK

Sustainable investing has gone from a niche investment idea to attracting enough start capital to having an impact on global challenges at a meaningful scale (Morgan Stanley 2018). This contrasts with earlier periods. The question then is, what is in it for workers and trade unions? Is there a real regulatory tsunami going on or are we talking about a consultancy hype (Parsons et al. 2020)? And are we really on the road to replace the (tacit) facilitation of regime shopping business strategies to evade labour standards by enforceable responsibility of companies for the working conditions of the suppliers' workers in their entire transnational value chain?

The most remarkable due diligence regulation at national level in Europe is certainly the 'Duty of Vigilance' Law that was adopted in **France** in March 2017.[24] The law is based on the United Nations Guiding Principles on Business and Human Rights, setting out the obligations held not only by companies but also by states to identify, prevent and mitigate the human rights-related risks linked to business relationships and activities. Several scholars have shed a light on the content of this 'duty of care' regulation (Clerc 2021, Savourey 2020, Collinet 2020) and, in the meantime, a first legal action was initiated. NGOs used the law to file action against energy multinational Total SE for failing to monitor the methods used by its subcontractors in Uganda to acquire land.[25] Also remarkable is a reference to the Act in an EWC-agreement (group Korian).

The French 'Duty of Vigilance' act is the only legislative example to date which imposes a general mandatory due diligence requirement for human rights and environmental impacts. The law imposes a duty of vigilance on large companies (employing 5000 employees in France, or 10,000 globally).

> *The law extends to the activities of French companies' subsidiaries and subcontractors and business enterprises in the supply chain 'with which the company maintains an established commercial relationship'. In order to discharge their legal duty, companies need to implement a 'vigilance plan' which should include reasonable measures to adequately identify risks and prevent serious violations of human rights and the environment (Smit et al 2020).*

The legislation seeks to prevent large companies from hiding behind their status as buyers. It establishes liability between the parent company of a corporation and its subsidiaries and subcontractors in the event of human or environmental rights violations. In short, it puts limits to the 'corporate veil' doctrine. Under this doctrine, companies were always seen as (a collection of) separate legal entities, even in case of parent

23 https://www.europarl.europa.eu/doceo/document/TA-9-2021-0073_EN.html
24 https://www.legifrance.gouv.fr/loda/id/JORFTEXT000034290626/ , in English: https://vigilance-plan.org/wp-content/uploads//2019/06/2019-VPRG-English.pdf#page=80
25 http://ens-newswire.com/2019/10/23/total-sued-under-frances-new-duty-of-vigilance-law/

companies and subsidiaries, and, as a consequence, a parent company could not be held liable for misbehaviour of the lower echelons of a production or services chain. The aim of the act is to prevent the risks and serious violations that activities of large French companies can generate with regard to human rights, workers' health and the environment. The liability extends not only to the activities of the parent company, but also to subsidiaries, subcontractors and suppliers with which it has an established business relationship. Companies must publish an annual 'duty of care' or due diligence plan setting out a range of preventive measures. Vigilance plans must include reasonable measures adequate to identify risks and to prevent severe impacts on human rights and fundamental freedoms, on the health and safety of individuals and on the environment, resulting from the activities of the company, its subsidiaries, suppliers and subcontractors. The plans must be prepared in collaboration with the stakeholders of the company and should cover a value chain assessment process, risk mapping, risk mitigation and preventive actions, alert mechanisms and monitoring systems on the effective and efficient implementation of measures. The alert mechanism must enable workers, NGOs and, for example, citizens living in the vicinity of a site or factory, to inform companies of any unidentified risks or adverse effects that may arise from their activities. The information must be open to the public and available on the company website and on a website that provides a list of companies covered by the law on duty of vigilance.[26]

Almost 4 years after the adoption, the assessment of the functioning of the law is still rather tentative. According to a list published in June 2020, 72 (or 27%) out of 265 identified companies that would be subject to the duty of vigilance had not published any vigilance plan over the last three years despite their legal obligation to do so. Among them are giants of the French economy such as McDonald's France, Yves Rocher, Avril, Castorama, Euro-Disney, Bigard, France Télévisions, KPMG, Picard (Bommier et al. 2020). Companies often deny that the size of the workforce goes beyond the threshold or they claim that this threshold only applies to the French territory.

The duty of vigilance requires companies to identify and monitor risks and to act upon them through ongoing mitigation and prevention measures. However, the plans often are too general or vague, without giving a clear indication of the workplaces or the names of the entities where risks show up. The risk maps make no mention of serious environmental risks or threats of workers' rights and therefore have an insufficient level of detail. Besides, alert systems are not always clearly located in the company (HR department or straight to the management?). Even more fundamental is the critic that the act is too much an act on paper; a company with a plan in place to prevent risks is difficult to tackle. Sometimes, audit systems are too weak to protect workers and whistle-blowers.

Some scholars conclude that, in order to ensure an effective implementation, France should give due reflection to the possibility of strengthening the law, namely by considering the opportunity to create and pass civil fines or criminal sanctions. Implementation of the law should also be backed by a list, prepared every year by the French authorities, of the companies that come within the scope of the Duty of Vigilance law (Sherpa 2020). NGOs involved recommend at European level a public country-by-country reporting policy so that large companies need to publish each year a certain amount of information of general interest on their activities country by country (list of all their subsidiaries and activities, turnover, profits, taxes paid, number of employees, subsidies received, value of assets, number of sales and purchases). Others plead for a Directive at EU level that prescribes a 'vigilance plan' containing reasonable but adequate measures to identify risks and to prevent severe impacts on such rights. Such a Directive should include appropriate internal monitoring arrangements (such as a 'vigilance committee' with stakeholder representation, including trade unions and worker representatives), proper external supervision (through a public supervisory agency tasked with setting up norms) and adequate remedies, including criminal sanctions, disgorgement of profits, and punitive damages (Clerc 2021).

26 https://vigilance-plan.org/

3

Joint & several liability

3.1 SUBCONTRACTING LIABILITY FOR LABOUR STANDARDS, SOCIAL SECURITY AND TAXES

In general, subcontracting liability measures regarding wages, and health & safety at the workplace have been established at national level with the primary aim to protect both fair competition and the workers engaged in a subcontracting chain. Next to that, subcontracting liability with regard to social security premiums and taxes exists and has the predominant aim to protect the state and social insurance funds income.

At the level of international law, there is a lack of clear arrangements concerning the liability in production chains (Vytopil 2015). Most often the 'corporate veil' doctrine, according to which separate legal entities such as parent and subsidiary companies are liable only for their own infringements exempts a parent company from liability for obligations of a subsidiary – even if it holds 100 percent of the subsidiary's shares – and even less so for breaches of the law by subcontractors.

Regarding the EU level, several Directives have been adopted with regard to cross-border subcontracting liability. For an extensive comprehensive overview, we refer to studies conducted in 2008, 2012 and 2016, analysing European legislation on the legal systems in the Member States, revealing loopholes as well as fraudulent practices (Houwerzijl 2008, Jorens 2012, Haidinger 2016). The most recent elaborated update of such practices and possible solutions, was made in 2017 in a report commissioned by the European Parliament (hereafter: the 2017 EP study).[27] It provides an overview of liability provisions in place at EU level and a comprehensive picture of the legal systems in place in five EU Member States regarding liability in subcontracting chains.[28]

At the EU level, the Employers Sanctions Directive 2009/52/EC provides - at least in theory - the most far-reaching subcontracting liability measures. The Directive introduces chain liability (to the next intermediate contractor higher up in a layer of subcontracting) in sectors without chain liability. This subcontracting liability is solely targeted against employers of illegally staying third-country nationals. The Directive aims to reduce the attractiveness for employers to employ workers who are illegally staying in the EU by introducing a liability regime. Article 8 stipulates a direct joint and several liability for the contractor of which the employer is a direct subcontractor. Moreover, if the employer is a subcontractor, the main contractor and any intermediate subcontractor may also be liable to pay fines, if they knew that the employing subcontractor employed irregular migrants. This establishes a full chain liability, which implies in principle the strongest protection and highest preventive effect as possible, because every link of the subcontracting chain is a possible debtor. However, the wording of article 8.2 suggest that all links must have knowledge ('the main contractor and any intermediate subcontractor, where they knew that the employing subcontractor employed illegally staying third-country nationals'). Another interpretation in sense of a liability of those in the chain, who know apart from those who do not, is thus possible. Next to that, Member States may 'water down' the chain liability by exempting the contractor that has undertaken due diligence obligations (article 8.3). According to the 2017 EP study, this makes it very easy to escape liability if the employer possesses and presents a written statement in which the direct subcontractor confirms that no third country nationals illegally staying are employed. In such a case, it will be even more difficult to prove any knowledge of the contractor or other links in the chain.

27 A. Heinen, A. Müller, B. Kessler, *Liability in Subcontracting Chains: National Rules and the Need for a European Framework*, Brussels: June 2017, commissioned by the European Parliament.

28 Germany, Italy, Hungary, The Netherlands, Poland.

The main focus in this overview is on the implementation of the PWD Enforcement Directive 2014/67, which includes in Article 12 a provision on cross-border joint and several liability for the payment of wages in subcontracting chains. The Enforcement Directive stipulates a concept of a direct joint and several liability, extending liability to one link up in the chain only, in respect of any outstanding net remuneration (according to the minimum rates of pay of the host state) and/or contributions due to common funds or institutions of social partners regulated by law or collective agreement (as far as these are covered by Article 3.1 PWD). While Member States are required to introduce such subcontracting liability in the construction sector and cover at least unpaid net remuneration corresponding to the minimum rates of pay (Article 12.1), they may provide for it in any sector, also for more tiers than only towards the direct contractor and with a broader scope than minimum rates of pay (Article 12.2 and 12.4). Instead of such a system of subcontracting liability, Member States may take other appropriate enforcement measures (Article 12.6).[29] All these measures have to be taken on a non-discriminatory and proportionate basis. A 'flanking' measure which would strengthen the liability instrument is laid down in Article 11 of the Enforcement Directive. This provision enables trade unions and other third parties, such as associations, organisations and other legal entities having a legitimate interest in compliance with the PWD, to engage, on behalf or in support of the posted workers, and with their approval, in any judicial or administrative proceedings.

In their implementation, some countries introduced new measures on joint and several liability, in particular in the context of public procurement and regarding temporary agency work. Nevertheless, considerable differences were observed in the EP study of 2017 in terms of scope between the Member States examined: While Germany, Italy[30] and the Netherlands have very far reaching and elaborated systems of chain liability, sometimes even covering all wage components, Poland, the UK and in part Hungary are pursuing a policy strictly according to the minimum requirements of the Enforcement Directive.[31]

In line with previous assessments, the authors of the EP study in 2017 assessed the effectiveness of the Enforcement Directive chain liability measure as limited, since it is relatively easy to circumvent by inserting a letter box company.[32] Moreover, the provision includes an escape clause lacking any definition of due diligence, which results in a wide margin of interpretation and therefore legal uncertainty.[33] Furthermore, liability is still restricted to the construction sector despite clear evidence of the practice of subcontracting spreading on to other sectors like transportation, meat processing, agriculture and other labour intensive sectors (albeit that Member States are free to expand the scope to these sectors).

According to the 2019 report of the European Commission,[34] based on replies to a questionnaire sent to the Expert Committee on Posting of Workers, the liability rules have not yet been frequently applied in practice as there are no relevant court cases. Nonetheless, several Member States (Belgium, Bulgaria, Croatia, Denmark, Germany, Finland, Italy, Lithuania, Luxembourg, Malta, the Netherlands and France) indicated that the introduction of these rules has increased the effective protection of the workers' rights in subcontracting chains. A remarkable observation is that 15 of the current 27 Member States seem to apply provisions of subcontracting liability only to foreign service providers, although it is clearly stipulated that it is not allowed to set up a system of subcontracting liability which applies only to cross-border service providers, as this would directly discriminate against those service providers.[35] Such system could discourage customers' final clients and contractors to contract or subcontract with undertakings established in other Member States.[36]

29 Only Denmark and Finland made use of that, according to the EC report of 2019.

30 Re Italy the assessment showed very strict liability rules, but since foreign subcontractors and posting are less relevant than in other Member States and Italy is 'traditionally facing issues with the enforcement of rules', there were doubts regarding the preventive impact in reality.

31 The report (2016) T*ransnational posting of workers within the EU. Guidelines for administrative cooperation and mutual assistance in the light of Directive 67/2014/EU* ENACTING (VS /2015/0013), also contains an examination of the subcontracting liability rules in Belgium, Germany, Italy and Romania.

32 However, due to the at that time recent implementation in mid-2016, there was no reliable data or practical experience with the flanking measures of Art. 4 and 11 of the Enforcement Directive.

33 In contrast, paragraph (2) of the first draft of Art. 12 provided a prestructured due diligence proposing how a reasonable due diligence could be performed and implemented into national legislation.

34 Brussels, 25.09.2019, COM (2019) 426 final.

35 National law on liability rules in Austria, Estonia, Hungary and Italy seem to apply to any situation (not only subcontracting) when an employer engages into a contract with a service provider established in another Member State.

36 COM (2019) 426 final, p. 17-18. These 15 MS are Austria, Bulgaria, Croatia, Czech Republic, Estonia, Hungary, Ireland, Latvia, Lithuania, Malta, Poland, Portugal, Romania, Slovakia, Slovenia.

3.2 THE NATIONAL OUTLOOK

Already before the adoption of the PWD in 1996, **Germany** introduced a chain liability regime for the construction sector, which was gradually expanded to other 'high risk' sectors and linked to the payment of wages in extended collective agreements. Since the entering into force of a statutory minimum wage in 2015, the chain liability instrument applies regardless of specific economic sectors. Pursuant to Art. 14 of the national Posting of Workers Act (*Arbeitnehmerentsendegesetz: AEntG*) in conjunction with Art. 13 of the Minimum Wage Act (*Mindestlohngesetz: MiLoG*), the contractor is held liable for any depth concerning (minimum-) wages as well as social fund payments. According to Art. 8 AEntG the liability applies irrespective of any fault or responsibility. Moreover, this liability applies irrespective of any preventive measures of the contractor, even the most thorough due diligence will not prevent possible liability as there is no escape clause. As a result, unpaid workers are entitled to claim their net wages directly from the contractor without the need of prior action against their employer. The only clear gap in the protection is that the final client is not deemed to fall under the scope of *MiLoG* and *AEntG* in a majority of the cases.[37] In particular in the context of public procurement this is a missed opportunity, since it exempts the public tenderers from liability.

Temporary agency workers (TAW) are normally excluded from the scope of the chain liability, since the contract between a TAW-agency and the user undertaking is considered a commercial contract. However, in subcontracting chains an exception applies if a TAW-agency has been commissioned by a direct contractor or subcontractor of the principal in order to fulfil contractual obligations. Although an exception, this should apply to almost every subcontracting chain involving TAW-agencies as subcontractors. A more general reform in 2017 in **Germany** enhanced the position of TAW-workers and tackled several abusive forms of TAW such as the phenomenon of so called 'Chain Leasing' (*Kettenverleih*) in the framework of subcontracting. This has been made impossible under the revised law. With effect of the 1st of April 2017, 'Chain Leasing' is prohibited according to § 1 AÜG. Temporal workers may be assigned by their contractual employer only, not by third parties. A violation is sanctioned with a high fine and the employment relationship of the agency worker will be conversed in an open-ended employment contract with the contracting user undertaking (§ 10a AÜG). A second circumventive practice that was tackled by the reform is 'hidden supply of temporary workers' (*'verdeckte Arbeitnehmerüberlassung'*). This often involves pseudo self-employed workers.

In earlier research (Cremers 2019), there was already reference to the Austrian act on tackling social fraud ('*Sozialbetrugsbekämpfungsgesetz', SBBG*) that defines artificial corporate legal entities or 'bogus' companies ('*Scheinfirmen'*). The legislation uses the term for corporate legal entities without assets (i.e., letterbox companies, often with registered offices in empty premises). The sole purpose of these firms is registering employees with social security institutions, without the intention of paying any taxes or social security contribution. The firms appear in 'subcontracting pyramids' (extended chains of subcontractors) and in extended corporate networks (at national and at transnational level). Combined with the Act tackling Wage and Social Dumping (*'Lohn- und Sozialdumping-Bekämpfungsgesetz',* LSD-BG) that came into force on 1 January 2017 this legislation, with a strong focus on the construction industry, can be applied in situations of subcontracting. A key provision is the liability of the client/user undertaking. Pursuant to § 9 LSD-BG remuneration claims for employees from other countries who are posted or hired out to work in the Austrian construction industry are secured. However, this liability is limited to the immediate client, unless obvious evidence of fraud was available at the start. The legislator can apply in severe cases of wage dumping not only substantial penalties, but also the withdrawal of trade licenses.

In **the Netherlands**, liability in the chain is to a certain extent covered by provisions in the generally binding collective agreements. Several sectoral collective agreements that are generally binding, for instance in the construction sector and affiliate trades, the metal sector and the international transport sector, contain an important reference to the obligation to ascertain the compliance with the hard core of the provisions in the prevailing sectoral agreements by hiring firms and subcontractors. The main contractor must ascertain that the involved workers receive the wages and allowances to which they are entitled according to these sectoral agreements. The main user undertaking is responsible for the correct application of the prevailing agreement in the sector and has to inform the subcontractor and/or agency about the concerned provisions. Non-compliance or default with this duty to inform and verify provides the trade unions with the right to go to court

37 2017 EP study, p. 74. Also, extensively on the so-called "Mall of Berlin" case (*Arbeitsgericht Berlin, Urteil vom 03.05.2017 – Az. 14 Ca 14814/16*): Vladimir Bogoeski 2016.

and order compensation through civil proceedings. This duty is also prescribed in the generally binding collective agreement of the temporary agency sector in article 16 of that agreement, which says that the temporary agency worker is entitled to the prevailing remuneration in the user firm.[38] There is, in the meantime, case-law that penalises this non-compliance with awarding damages.[39] Case-law also has defined that the duty goes beyond basic information provision and presumes real verification.[40]

In the slipstream of the implementation of the revised PWD, Sweden adopted a Bill in November 2020 that introduces a so-called 'economic employer' concept in Swedish tax law.[41] The legislation entered into force on 1 January 2021. It results in Swedish tax liability for many short-term workers and business travellers employed abroad, who have not previously been subject to tax in Sweden. This new employer concept means that the assessment of who is considered the employer – from a tax perspective – is now based on the beneficiary of the employee's labour. This leads to changes in the '183-days-rule' which Sweden applies in line with Art. 15 of the OECD tax convention. Consequently, the 183-day rule usually results in tax exemptions for foreign individuals for up to six months, if the employee remains employed by the foreign employer in its own jurisdiction and if this employer actually pays the salary. According to the new legislation, the 183-day rule will no longer apply if the employee's activities are considered as hiring of labour to a Swedish company. The definition of 'hiring of labour' for non-resident employers includes situations where:

- the non-resident employer directly or indirectly makes an individual available to perform labour;
- the client's business is located in Sweden; and
- the labour is performed as an integrated part of the client's activities and under the client's control and management.

Thus, the new legislation will result in Swedish taxation from day one for many foreign employees working temporarily in Sweden. This means that also foreign employers without a permanent establishment in Sweden will now need to withhold preliminary tax for their employees (to the extent that the work has been carried out in Sweden) and have to comply with reporting obligations such as registering with the Swedish tax administration STA. An exemption applies if the work in Sweden does not exceed 15 consecutive days and is for a maximum of 45 days per calendar year. Further, if the 45-day limit is exceeded, the exceeding days only should be subject to determine whether the work carried out in Sweden can be seen as the hiring of labour.

38 For an English text of the collective agreement 2019-2021 in the temporary agency sector, see: https://www.abu.nl/app/uploads/2019/11/CAO-voor-Uitzendkrachten-2019-2021-december-2019-EN.pdf
39 https://linkeddata.overheid.nl/front/portal/document-viewer?ext-id=ECLI:NL:RBNNE:2015:1076
40 https://www.sprengersadvocaten.nl/publicaties/schadevergoeding-voor-vakbond/
41 This part of the report draws on New rules on posting of workers in Sweden - Newsletters - International Law Office

4 Transparency and reporting

4.1 DISCLOSURE OF ENVIRONMENTAL, SOCIAL AND OTHER NON-FINANCIAL INFORMATION

Measured to the large number of publications in recent decades on non-financial reporting one might easily get the impression that the publication of societal impact and consequences of corporate behaviour is increasing. The interest in this information, notably after the financial crisis has led to new initiatives in reporting frameworks, codes, rules, practices, and handbooks that guide the business environment through the process of disclosure. In general terms, the applicable regulatory framework and the societal context in which a firm operates, the dialogue with its stakeholders and other factors, such as transparency on ethical choices and applied norms and standards lead the way. However, there are no universally agreed mandatory objectives and standards for such disclosure. Companies have the choice and apply different types of reporting, whether through separated reports dedicated to particular subject matters, themes, objectives or requirements, through integrated reports that cover all subject matters or through mixed forms with intertwined reports.

Non-financial reporting, especially the disclosure of sustainability items, is becoming standard practice for large and mid-size companies; it is however, far less common among small and mid-size companies. Moreover, it is not quantity that counts, the key question is what the quality of this type of information is. Assessments often reveal that companies use generic, vague and non-specific language and terminology. And in general, social key performance indicators are less prevalent than the more established environmental and human rights parameters. Sustainable developments goals are seen as a roadmap to global transformation. Circular business approaches that deal with sustainability are more and more presented as 'big business', with new and better growth and profit opportunities, going far beyond environmental, social and governance reporting, presenting a vision for reshaping entire industries towards long-term value creation. Social reporting is less marketable and social indicators are often limited to reporting on diversity in recruitment and to the safety and health of workers.[42]

Over the last decades, a new branch of advice and assistance with the development of a reporting strategy and external disclosure processes has emerged: business consultancies that provide reference (or even complete blueprints) for companies that want to disclose in reports.[43] This can lead to copy-paste products or to an annual ritual of reporting based on 'boilerplate disclosures', i.e. generic statements that are not specifically tailored to the individual company and the risks it faces (SASB 2017). In an early assessment, several of these statements with great similarity were found, probably prepared by the same consultancies that companies

42 Interestingly, assessments reveal differences between continents. For instance, *the State of Disclosure in 2017* report of the Sustainability Accounting Standards Board Foundation (SASB) says: At U.S.-based firms, boards of directors often view maximization of share-holder value as the number one priority of their fiduciary duty. Meanwhile, companies in other parts of the world, most significantly in Europe, typically consider the interests of a broader group of stakeholders, including employees and clients. As a result of this difference, such companies may be more culturally attuned to their sustainability impacts and more likely to disclose relevant information (SASB 2018), https://www.sasb.org/knowledge-hub/state-of-disclosure-2017/

43 For instance, the online platform Reporting Exchange (www.reportingexchange.com) records details of reporting provisions that directly or indirectly influence the way in which companies report their information. Its Indicator Library organises, categorises and structures the indicators that companies commonly apply for external reporting.

hired in (Cremers 2013). Critics talk about companies that are engaged in 'impact washing', with as a result that their reporting claims to support sustainable goals while being implicated in conduct that may belie that support.[44]

ShareAction, an NGO that mobilises investors to take action to improve labour standards, tackle the climate crisis, and address pressing global health issues, such as childhood obesity, published a report that digs a bit deeper in the commitment to human and labour rights in the policy documents and reporting of companies (ShareAction 2020). As part of the ambition for 2030, the UN Sustainable Development Goals make a commitment under Goal 8 to end modern slavery, ensuring the protection of labour rights and safe conditions for all workers, whilst one of the targets for Goal 16 includes significantly reducing all forms of violence. ShareAction's assessment looked at 75 of the world's largest asset managers and their performance on responsible investment, with one of the three areas of focus being on human rights (alongside climate change and biodiversity). The assessment found that the industry's money is overwhelmingly being used in a way that at best neglects human and labour rights abuses and at worst contributes to them. While 76% of the world's largest asset managers say they have a commitment to human rights, if assessed, just 4% of managers make firm and specific policy commitments on human and labour rights. The main reference to labour issues is financial risk, most commonly related to occupational health and safety, and operational risks, such as staff unrest due to poor labour practices, poor staff retention, and poor productivity.

Other studies confirm the conclusion that the main focus is on the 'E', with social reporting lagging behind. Three charities (*Friends Provident Foundation, Joffe Trust and Blagrave Trust 2021*) concluded in their ESG impact assessment of the investment sector that social issues were in some cases not covered at all. According to the NGOs, the 'S of ESG' should be placed more firmly on the agenda. Key social issues, from decent work and working conditions, including the promotion of fair pay, to workforce and management diversity and the responsible payment of tax require far greater attention and integration.

From a broader perspective of the commitment to human rights instruments, an assessment in 2017 revealed that the application of human rights standards lacked coherence across the EU, due to an uneven adoption and implementation of international human rights instruments. Although the EU has endorsed the main international instruments aimed at promoting corporate social responsibility, there is a divide in EU policy between civil and political rights, which are enforceable and a priority, and economic, social and cultural rights. Moreover, the same authors write that there remains a considerable gap in translating the endorsement into concrete support, and in increasing awareness and compliance with these instruments by the EU itself, by the Member States, in third countries, and by businesses operating within the EU and global markets (FRAME 2017). Another weakness is that much of the delivery of the EU's commitment depends on the willingness of Member States to play along. Internally, some Member States are implementing reforms that are plainly averse to such commitment, and the EU currently struggles with putting effective instruments into place to tackle these developments. Too often human rights considerations are de facto superseded by 'hard interests', ignoring increased risk of poverty, widening inequalities, or an erosion of social protection. This goes hand-in-hand with a relatively low level of knowledge of the EU's commitment among EU officials, rigidly organised in silos, who struggle to reflect on cross-cutting issues in their specialised administrations. Coherence requires the coordination of economic, social, and environmental policies at the internal and external level. All levels of power, from EU Member States to EU institutions and other EU bodies, need to act such that they do not offset the commitment through contradicting policies. This requires a 'rights-based' approach, instead of a rather piecemeal approach, aligning policies vertically between the EU and its Member States as well as horizontally among EU institutions such as the Commission Directorates-General, or Council Working Groups.

44 According to an article in the *Responsible Investor (2-10-2020)*: 'Most standardized information provided by companies covers only "traditional" ESG performance metrics, e.g., carbon emissions, water consumption and employee injury rates. SDG-related reporting is generally anecdotal, pertaining to specific projects and initiatives and lacking a full assessment of companies' impact on society and the environment throughout the value chain.' https://www.responsible-investor.com/articles/assessing-company-alignment-with-the-un-sdgs

4.2 THE REGULATION OF NON-FINANCIAL REPORTING

The reporting task can be based on mandatory legal requirements or fit in a voluntary framework that provides the reporting entity with guidance and suggested codes. The 'binding' character varies in character; most requirements can be seen as 'soft law', with (only) normative expectations and standards (Global Reporting Initiative 2018, Alliance for Corporate Transparency 2019, EFRAG 2021).

One of the key principles used in monitoring is the mainstream instrument, generally applied in corporate governance, of 'comply or explain'. Due to the voluntary nature and the lack of stringent monitoring mechanisms, adherents often do not tend to adopt costly steps to comply with requirements. Instead, companies rather adopt symbolic, low-cost steps to convey the impression of obligation compliance. Although it looks as if, in recent years, a surge in legislation on corporate reporting has taken place, there remains an absence of concrete legislation on mandatory due diligence on labour standards. Almost all legal reporting schemes, formulated in mandatory non-prescriptive requirements, prescribe the themes of the envisaged information, but do not prescribe the required content in details.[45]

The following scheme summarises some prominent guidelines and principles that are applied.

Human and labour rights frameworks – overview of guidelines and principles

UNITED NATIONS GUIDING PRINCIPLES ON BUSINESS AND HUMAN RIGHTS (UNGPS)

The UNGPs are a set of guidelines for states and companies to prevent, address and remedy human rights abuses committed in business operations. The UNGPs are not legally binding, but function as normative expectations. The UN Guiding Principles Reporting Framework is a comprehensive guidance for companies on how to report on their respect for human rights. The Framework is supported by an implementation guidance for reporting companies and an assurance guidance for internal auditors and external assurance providers.

UNITED NATIONS GLOBAL COMPACT (UNGC)

The UNGC is comprised of 10 social and environmental principles (six refer specifically to human and labour rights) aimed at mobilising companies to participate and report in line with progress on these principles. UNGC aims to engage and exclude companies based on breaches. Firms that fail to report progress on the UNGC are delisted, and companies that are not eligible to join due to the nature of their core business activities are not listed.

INTERNATIONAL LABOUR ORGANISATION (ILO) FUNDAMENTAL LABOUR STANDARDS

ILO-standards set out basic principles and rights at work. The conventions (of which eight so-called fundamental conventions cover the 'core' labour standards) are legally binding international treaties that may be ratified ILO by Member States. In addition, there are ILO-recommendations serving as non-binding guidelines, often to supplement a convention by providing more detailed guidelines on how it could be applied.

OECD GUIDELINES FOR MULTINATIONAL ENTERPRISES AND RESPONSIBLE BUSINESS CONDUCT FOR INSTITUTIONAL INVESTORS

The OECD Guidelines for Multinational Enterprises are recommendations that cover a range of responsible business thematic areas, including employment and industrial relations. They provide non-binding principles and standards for responsible business conduct for multinational corporations, including investors, operating in or from countries adhering to the Declaration on International Investment and Multinational Enterprises. Non-compliance with OECD guidelines can lead to grievances being filed.

45 To mention a few jurisdictions that enacted legislation: the 2015 Modern Slavery Act in the UK, the Dutch Child Labour Due Diligence Law, the French 2017 Duty of Vigilance Law, and the EU Non-Financial Reporting Directive.

EU Directive 2014/95/EU on non-financial reporting, formulated as an amendment of Directive 2013/34/EU on annual and consolidated financial statements, prescribes large listed EU companies and financial corporations to disclose information on environmental, social, human rights, bribery and anti-corruption matters in order to enhance the consistency and comparability of non-financial information disclosed throughout the EU. The disclosure should contribute to a better understanding of a company's position, performance, development and impacts. Companies falling under the scope of the Directive are requested (in line with article 3.1 of the Directive 2014/95/EU) to include a non-financial statement that discloses information on their business model, policies and due diligence and the outcomes of their policies, principal risks, and key performance indicators (KPIs) with respect to environmental, social and employee matters, as well as bribery and anti-corruption matters, relevant to their business. The Directive does not prescribe the exact content; to formulate this is up to a company's discretion.

According to research of the Alliance for Corporate Transparency (2020), the quality of corporate reporting practices varies among EU companies and across Member States. Notably, most undertakings in all Member States fail to disclose relevant, material, meaningful and comparable sustainability information, underscoring the need to clarify and specify reporting requirements for companies. The Alliance has criticised the lack of clear definitions which specify information and KPIs companies must disclose, as well as the specific matters they should address. Besides, the general reporting requirements listed in the Directive allow contradicting interpretations. This undermines the objective of the law to increase the consistency and comparability of ESG information.

The European Commission announced in 2020 to review the non-financial reporting directive as part of the strategy to strengthen the foundations for sustainable investment. At the moment of writing the Directive's revision is discussed.[46] Several stakeholders have published their opinion on the reform proposal after the Commission launched a public consultation. As the legal consequences are yet unclear, this is not further elaborated upon in detail in the frame of this research. In the meantime, important proposals for a revision of the directive have been formulated. In the frame of this research, we refer to these proposals (i.e., EFRAG 2021).

4.3 DISCLOSURE OF (SUBCONTRACTING) CHAIN INFORMATION

However, what is assessed here is the reference in the non-financial reporting area to liability aspects in chains of production or services, with subcontracting entities and/or subsidiaries. Directive 2013/34/EU on annual financial statements, consolidated financial statements and related reports only refers to due diligence when sourcing minerals. The amending Directive 2014/95/EU on non-financial reporting makes reference to subcontracting issues in its preambles. Recital 6 of the Directive stipulates that the non-financial statement should also 'include information on the due diligence processes implemented by the undertaking, also regarding, where relevant and proportionate, its supply and subcontracting chains, in order to identify, prevent and mitigate existing and potential adverse impacts'. And recital 8 adds 'The risks of adverse impact may stem from the undertaking's own activities or may be linked to its operations, and, where relevant and proportionate, its products, services and business relationships, including its supply and subcontracting chains.' This can be read as a provision that aims to ensure that the outsourcing of production does not imply the outsourcing of responsibility. However, this notion is not included in the articles of the Directive and, therefore, the legal character is weak. In the core text, no further reference is made to subcontracting. Moreover, the wording is cautious and non-committal, with conditionalities such as 'relevant and proportionate' and reference to 'undue additional administrative burdens' for small and medium-sized undertakings.

A second aspect that is important for the purpose of our research, is the scope of the disclosure: does it cover the activity as a whole or is it limited to a single economic entity. Directive 2013/34/EU on annual and consolidated financial statements prescribes that consolidated financial statements should present the activities of a parent undertaking and its subsidiaries as a single economic entity (a group) as soon as the average number of employees during the financial year exceeds 250 employees. Undertakings controlled by the parent undertaking should be considered as subsidiary undertakings. A subsidiary undertaking which is itself a parent undertaking should also draw up consolidated financial statements. Nevertheless, Member States can exempt such a parent undertaking from the obligation to draw up such consolidated financial statements in certain

[46] https://ec.europa.eu/info/business-economy-euro/company-reporting-and-auditing/company-reporting/non-financial-reporting_en

circumstances, provided that its members and third parties are sufficiently protected. The requirement to prepare consolidated financial statements is formulated in article 22 of Directive 2013. Directive 2014/95/EU does not speak about single economic entities. However, recital 14, which exempts SMEs, stipulates that the obligation to disclose a non-financial statement should apply only to those large undertakings which are public-interest entities and to those public-interest entities which are parent undertakings of a large group, in each case having an average number of employees in excess of 500, in the case of a group on a consolidated basis. Article 29a lays down the content of the consolidated non-financial statement containing information to the extent necessary for an understanding of the group's development, performance, position and impact of its activity, relating to, as a minimum, environmental, social and employee matters, respect for human rights, anti-corruption and bribery matters. This should be formulated, among others, in a description of the policies pursued by a group, a listing of principal risks related to those matters linked to the group's operations and how the group manages those risks. Where a group does not pursue policies in relation to one or more of those matters, the consolidated non-financial statement shall provide a clear and reasoned explanation for not doing so. The reporting of activities of subsidiaries is mentioned in recital 3 of the Directive 2014/95/EU, where it is said that an undertaking which is a subsidiary undertaking shall be exempted from the obligation to report if that undertaking and its subsidiary undertakings are included in the consolidated management report or the separate report of another undertaking.

Critics have noted that the practical implementation and application is problematic (Emons 2021). Several NGOs and scholars evaluated the functioning of the EU Directive and concluded that companies' reporting at large is insufficient; reports are not presented in an accessible way and information on risks, impacts and their management is often incomplete or lacking. Others have assessed the weaknesses of the Directive especially regarding the monitoring of the reporting and the enforcement of duties. In general terms, most critics speak about the need to create more clarity, consistency and comparability across the value chain. Clear indicators are needed that underpin the level of compliance and can be used to assess a particular situation before designing policy, to benchmark a policy for monitoring purposes, or as a control variable when evaluating policy. Only then, evaluations of the impacts of an existing or a future measure can take place in a transparent way.

As a complete assessment of the Directive is not subject of this study, we will withdraw from a detailed review and pinpoint the further analysis to subcontracting and chain liability issues.

4.4 THE NATIONAL IMPLEMENTATION AND THE PLANNED REVIEW

Directive 2014/95/EU neither introduces nor requires the use of a non-financial reporting standard or framework, nor does it impose detailed disclosure requirements such as lists of indicators per sector. Most Member States implemented the lean and flexible character of the Directive without providing further details on the types of policies that may be reported on, or how their outcomes could be measured. Several Member States introduced the so-called 'Safe Harbour Principle' according to which a company may, in exceptional cases, refrain from providing information if disclosure of this particular information is likely to cause significant damage to the business in the course of ongoing negotiations or litigation. Also, the notion that information on business relationships should only be included in the report when 'relevant and proportionate' (as prescribed by the Directive) was welcomed by most Member States.

After the implementation, only the Italian legislation explicitly referred to the notion in the Directive that business relationships include supply chains and subcontractors and France made reference to a Duty of Care of parent companies and ordering companies, including the reporting of outsourced work and of social and environmental responsibility in relation to suppliers and subcontractors (Frank Bold 2017).

The European Commission has admitted that after the national implementation in 2018, the non-financial information disclosed by companies does not adequately meets the needs of the intended users. In the EC consultation launched in the frame of a planned drafting of a revision of the Directive, questions were raised related to the narrow scope of the Directive and the possible exemption of subsidiaries. The Commission is aware of the fact that these exemptions limit the information about impacts on society and the environment, thus undermining the ability of stakeholders of such exempted subsidiaries to hold the involved forms accountable for their impacts on society and the environment, especially at local and national level.

Special attention is paid to the way in which companies address fundamental rights and manage related risks, including in their supply chains. The aim of the revision is 'to have indirect but significant positive impacts on social issues, for example on labour standards, non-discrimination and social inclusion' by the introduction of additional reporting requirements.[47]

Despite their rather weak legal character, the idea that the provisions in relation to principal risk are intended to include supply chain factors, as well as the company's own operations has gained ground in recent years. But overall, most attention is still given to practices related to, for instance, the supply of raw material. An approach from the perspective of a supply of services or products by independent subcontractors is less common. Engagement regarding supply chains and subcontracting, paying attention to human and worker rights, such as the ILO core conventions and labour standards, stays weak (Friends Provident Foundation 2020). A more detailed assessment from the workers' perspective of national experiences reveals that the reporting potentially could contain valuable information, though not in the current or expected form based on the requirements set out in the Directive.

Decent reporting on (fundamental) labour standards and workers' rights has to deal with both, internal employees (freedom of association, non-discrimination and health & safety) and external workers (the monitoring of social factors and aspects in the supply chain). It is not only a written proof of firms' commitment, but should also inform about the concrete implementation (Abriata 2020). Trade union representatives and workers' representatives at company level in all investigated countries criticise the fact that even though Directive 2014/95/EU refers to extensive information, the resulting reports present hardly any information on the sensitive matters which they are the most interested in. Often, data provided are unclear, sometimes crucial information is omitted, especially on subcontracting and/or the supply chain. Interviewees in an EU-wide project perceived the reporting exercise as a part of a company's marketing and communication strategy for meeting the expectations of the financial community and rating agencies, rather than as a true accountability tool (DimasoLab 2018). The conclusions drawn in that project were that uniformity and comparability have to be guaranteed through the use of recognised common international and national reporting standards. Furthermore, information about the supply chain and subcontracting should be obligatory, with clear legal definitions. For workers' representatives, comparability would significantly increase the value of the given information and enlarge possibilities to utilise it.

Over the years, the EU has developed in theory a strong commitment to fundamental rights, culminating with the Treaty of Lisbon, which gave the Charter of Fundamental Rights of the EU ('Charter') the same legal value as the EU Treaties and listed human rights among the Union's foundational values. Developments in a number of Member States over the last decade demonstrate a necessity for the EU to monitor the rule of law and fundamental rights in Member States, as well as in its own policies. The focus on democracy, good governance and human and social rights and on the mechanisms to safeguard these values has to be worked out further in the EU-legislation on non-financial reporting. This also requires a broad involvement of non-state actors, including civil society and the socioeconomic partners.

47 The Impact assessment, the consultation document and a series of replies can be found at: https://ec.europa.eu/info/law/better-regulation/have-your-say/initiatives/12129-Revision-of-Non-Financial-Reporting-Directive

Concluding remarks 5

5.1 LEGAL PROVISIONS IN CHAINS

A basic question is whether the corporate governance legislation/regulation is developed into an appropriate tool to integrate environmental and social objectives in public and private investment decisions and, moreover, whether the evolution of good governance practices has kept pace with the consequences of the externalisation of labour that has taken place in the last decades. Given the dominant ideology of deregulation of the business environment, the answer is probably no. Board members have relatively wide discretion when making decisions on behalf of a company on sustainability issues, but incentives within existing corporate governance models too often prevent them from taking concrete steps to act on these intentions. And workers' representatives have only few legally binding provisions to counteract these models (Emons 2021).

In recent decades, the focus has even narrowed from the broader sustainability notion to more exclusive environmental issues, such as the environment and biodiversity preservation. Often the transformation required in our economy towards sustainability is underpinned with arguments that sustainable corporate performance equates with better long-term value-creation for the company. In this kind of reasoning, financial arguments still prevail over societal effects and social values. Currently, this overshadows important social policies and issues like the enforcement of labour standards and the promotion of decent work, job security, excessive use of self-employed non-employees, gender inequality and widening income gaps, racial and social discrimination and the control of supply chains and associated risks.

In general terms, the more complicated a production and services chain is in cases of sub-contracting, the more difficult it is to establish legal responsibility for labour standards and employment rights along the chain of subsidiaries, suppliers and subcontractors. Chains are kept complex in part to shield the main firms from liability for economic risks and labour obligations. The liability of parent companies for the legal transactions of their subsidiary companies in transnational cases is also often neither regulated by statute nor recognised by courts. For instance, the lack of clarity in the scope of due diligence obligations of a parent company toward human rights violations of its subsidiary companies means that even in the most extreme cases, victims of violent repression have no legal entitlement to justice and reparation from the parent company. Therefore 'it is unsatisfactory, but not surprising, that these companies are difficult to hold legally accountable' for violations committed by their supplier companies (ECCHR 2014).

Effective statutory provisions regarding a company's due diligence obligations in supplying companies and subcontractors are scarce and it might also be very problematic to properly react to violations committed by one of the many hundreds or thousands of supplier companies that corporations have to deal with. In such a situation, it is not easy to find resources for pressuring the management to incentivise its subsidiaries and suppliers to act in a responsible way. Moreover, there is a clear lack of established procedures to operate across borders and limited understanding about which authorities are involved, and which procedures to follow, for instance when dealing with complex subcontracting chains that operate across many different countries. However, a subsidiary is more than a technical part of a parent company and not all subcontracting chains are far away from the core business. Outsourcing of production stages, subcontracting based on a division of labour or on specialisation, and the externalisation of labour recruitment through agencies are most often centrally planned. And as a result, managing and control of the production process and other decisive directives come in such a case from the controlling undertaking at the top.

5.2 PROBLEMS WITH COMPLIANCE AND REDRESS

Most regulations and standards are principles-based and enable a wide range of different frameworks to comply with. But almost all regulations lack legally binding effect with strong enforcement mechanisms and therefore, effective monitoring of standards across the value chain is problematic. There is still a large gap between corporates' commitments and their concrete management and implementation, partly because it is too easy to get away with window dressing. Practitioners, such as trade union officers, workers representatives and EWC-members, are often confronted with this gap between regulations of 'good governance' and the daily practice at the workplace. The disparity between the 'spirit of the law' and the 'law in action', i.e., the practical application of regulations, is time and again stemming from contradictions between several, in practice, intertwined (legal) areas concerning established business relations that are not treated in a coherent manner (for instance 'identity' versus 'corporate veil'). This goes hand-in-hand with a relatively low level of integral knowledge inside EU institutions and other EU bodies, rigidly organised in silos, who struggle to reflect on cross-cutting issues in their specialised administrations. Coherence requires the coordination of economic, social, and environmental policies at the internal and external level. All levels of power need to act such that they do not offset the commitment through contradicting policies. Moreover, the disparity can be the result of the subordination of social rights to the economic freedoms and the prevalence on an everyday basis of the promotion of the 'business environment'. It was already mentioned beyond that human rights considerations are too often de facto superseded by 'hard interests', ignoring increased risk of poverty, widening inequalities, or an erosion of social protection.

Related to compliance and enforcement this becomes manifest in:

a. A lack of preventive legal remedies at transnational level. The EU acquis does not provide for effective or dissuasive sanctions against the abuse of corporate entities in a cross-border context. In this respect, the acquis refers to national sanctioning mechanisms with national consequences. As a result, those affected can only rely on national judicial systems for preventive remedies, whilst the origins of the abuses are often the result of 'regulatory arbitrage' or 'regime shopping'.

b. A lack of clear arrangements concerning the liability in production and services chains. Most often the corporate veil doctrine, according to which separate legal entities such as parent and subsidiary companies are liable only for their own infringements exempts a parent company from liability for obligations of a subsidiary – even if it holds 100 percent of the subsidiary's shares – and makes it even less responsible for breaches of the law by supplier companies.

c. The absence of measures to ensure that parent companies can be held accountable for violations committed (abroad) by subsidiaries or suppliers. In such a situation, clear attribution regulations are required and companies should have their own clearly defined due diligence obligations. However, in most countries, due diligence obligations of parent companies regarding subsidiaries and suppliers are currently unclear or non-existent.

d. Insufficiently protected legal interests under civil law with weak complaint mechanism for large victims' groups and high financial risks for the workers lead to important barriers. Recent research for the ETUC on 'letterbox companies and company law' (Cremers 2019) revealed that the application of criminal law for corporate (mis)behaviour and the sanctioning of non-genuine corporate activities are often absent. Moreover, even the 'eligibility' in a foreign constituency can be problematic.

5.3 A VAST AREA AND AN EXTENSIVE BODY OF REGULATION

We realise that the subject of this 2nd stage covers a large and important area, with an extensive body of (non-binding) regulation and legislation. Given the limitations in time and budget, we have tried in the conducted work to provide an updated overview of the relevant aspects at stake, with a focus on legally binding provisions. Therefore, we synthesised existing studies and analysed and interpreted research from the angle of labour standards and employment rights.

The first section of this report reveals that the legal frame for subcontracting (in commercial or business law) excludes in general terms the existence of an employment relationship between a main contractor and a subcontractor. In recent years this has become a battlefield in court cases. The difference between a contract of service (a labour contract) and a contract for (the provision of) services is at the heart of many disputes in the gig economy (Uber, Deliveroo et cetera). In their tests, courts have been looking at subordination, autonomy, planning and other aspects that characterise the existence of a labour contract ('substance over form'). A second point that is relevant here is the allocation of the employer; subcontractors are the employer of their workforce and fully bear the related responsibilities. Interesting in this regard is the fact that for some working conditions (notably in the area of OHS) a joint responsibility has been settled as a default. But otherwise, most countries have few specific rules or conditions in place in the social field which concern subcontractors as legal entities. Finally, it can be concluded that chain liability provisions related to workers' rights or labour standards are, with some exceptions, only sporadically formulated in direct relationship with the regulation of subcontracting. The national examples of stricter regulation (limiting of subcontracting levels, strengthening of chain liability, verification duty, regulation of labour-only subcontracting or agency work) show great difficulties of applicability, enforcement and a lack of dissuasive penalties.

The second section examines the different international frameworks that address due diligence. Among others, due diligence requires a corporation to investigate third party partners for potential abuse of human rights. Overall, due diligence can be characterised as 'soft law'. Cases before court concern mainly civil law cases on environmental liability often brought against a parent company for harms which took place through the activities of its subsidiary, and raise questions of parent company liability and duty of care. Compliance with fundamental social rights, such as equal treatment, dignity or fair working conditions is less explored. Due diligence has also been introduced at EU-level in the Enforcement Directive 2014/67 that aims to strengthen the PWD. The demands for stronger regulatory action at EU level in order to protect workers, communities, and the environment from systematic, ongoing and worsening human rights and environmental impacts linked to the global supply chains of businesses and financial institutions are on the increase. The assessment of the French duty of vigilance legislation shows the need for a strengthening of the (still scarce) law in this respect, with better monitoring and adequate remedies.

The third section examines the legal frame for joint and several liability. At the level of international law, there is a lack of clear arrangements concerning the liability in production or services chains. At EU level, several Directives have been adopted with regard to cross-border subcontracting liability. And at national level, liability measures have been established regarding wages, health & safety at the workplace, social security premiums and taxes. In practice, legal uncertainty resulting from exemption clauses, the use of 'due diligence' and wide margins of interpretation makes it relatively easy to escape liability. Moreover, it is not self-evident for workers to claim their rights in civil proceedings, especially in a cross-border context. Relevant to mention here is the introduction in the Enforcement Directive of a provision that enables trade unions and other third parties, such as associations, organisations and other legal entities having a legitimate interest in compliance with the PWD, to engage, on behalf or in support of the posted workers, and with their approval, in any judicial or administrative proceedings. In some countries the application of chain liability has been strengthened. In Germany, it applies irrespective of any preventive measures of the contractor. Even the most thorough due diligence will not prevent possible liability as there is no escape clause. Other countries focus on the duty of verification at the top of the chain or the tackling of artificial corporate legal entities.

The fourth section deals with non-financial reporting. Reporting tasks can be based on mandatory legal requirements or fit in a voluntary framework that provides the reporting entity with guidance and suggested codes. The 'binding' character varies in character; most requirements can be seen as 'soft law', with normative expectations and standards. Non-compliance with codes cannot be brought to court. Due to the voluntary nature and the lack of stringent monitoring mechanisms, reports are often not presented in an accessible way and information on risks, impacts and their management is incomplete or lacking. There is a serious risk of 'impact washing'. The EU has taken steps towards a more binding regulation in 2014, with Directive 2014/95/EU on non-financial reporting. However, assessments reveal that most undertakings in all Member States, with the monitoring of the reporting and the enforcement of duties very moderately prescribed, fail to disclose relevant, material, meaningful and comparable sustainability information. Another serious weakness of the Directive is that there is only reference to subcontracting chains in the recitals, not in the core articles of the Directive.

Our analysis reveals that there is first and for all a lack of strong legally binding provisions. As far as chain responsibility and shared responsibility, irrespective of where the workers involved come from and under which legal status they work, are enshrined in law, the legal instruments are too often inadequate and ineffective. Our investigation reveals also that in many of the areas covered by international instruments that deal with or prescribe (aspects of) corporate behaviour the attention for labour rights (or human social rights) is lagging behind, or is even absent. Environmental concerns (and sometimes very generally formulated care for human rights) come first. In recent years, this has only slightly changed. Clearly, respect for and priority given to labour rights and standards is still not seen as 'business as usual', as an integral part of the functioning of a business. Companies rather adopt symbolic, low-cost steps to convey the impression of obligation fulfilment. Assessments in this regard speak about costs, risks and incentives, not about societal goals and social objectives.

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