

TEN STEPS TOWARDS ENFORCEABLE DUE DILIGENCE REGULATIONS THAT PROTECT FORESTS

By **Jade Saunders**

INTRODUCTION

Change is in the air. New regulations to address deforestation are under development in the EU, UK, and US and there is a groundswell of support, from civil society and corporate actors alike, for Due Diligence requirements to form the backbone of such legislation. This development is timely; a host of academic research now illustrates the importance of voluntary commitments to tackle deforestation. However, effective Due Diligence is not necessarily easy to legislate for.

Next month a decade will also have passed since the EU passed the EU Timber Regulation (EUTR), one of the first mandatory Due Diligence laws in the world. Since the EUTR came into force in 2013, there have been a number of critical lessons to be learnt from both the successes and limitations of the Regulation, as well as other laws, notably in the US, which aim to tackle illegal and unsustainable products in global supply chains. These lessons must inform future regulation if it is to have any chance of success.



- 1 Penalties for non-compliance are an essential element of new regulations that will have the power to change company behavior:** Voluntary measures alone are insufficient to successfully address commodity-driven deforestation at the global scale. Academic studies indicate that neither company zero-deforestation commitments nor the Amsterdam Declaration Partnership have had much or any impact on halting deforestation (Reis *et al.* 2020). Soy data from Trase (2018) also show that companies with zero-deforestation commitments do no better than companies that have not made any commitments. Similarly, signatories to the Amsterdam Declaration were exposed to similar or even higher levels of relative deforestation risk than non-signatory China, with no discernible decline in deforestation risk since the Declaration came into force.

Regulations to address this existential global threat are therefore under development in the EU, UK, and US. There is no doubt that new laws should build upon what has been achieved voluntarily to date. Voluntary corporate zero-deforestation commitments are helpful and should continue to be encouraged, applauded, and monitored. Voluntary action by leading companies builds confidence that regulation is not an economic threat. But simply encoding the existing stepwise progress model in legislation without the possibility of litigation or penalties for non-compliant companies is unlikely to change the current global deforestation trajectory. In a Forest Trends Timber Regulation Enforcement Exchange (TREE)¹ survey of enforcement officials responsible for regulations designed to tackle the trade in illegally harvested timber,² over 82 percent of respondents agreed or strongly agreed that penalties are an essential element of any new regulation to require due diligence from companies buying agricultural commodities, if it is to effectively reduce deforestation.

Under the EUTR penalties have been used increasingly in the last few years as enforcement pressure has increased. While financial penalties issued by courts may not be the most effective way of penalising newly regulated companies trading in agricultural commodities (see 9 below). Over 58 percent of survey respondents responsible for enforcing the EUTR believe that penalties are not currently proportionate or dissuasive, and 54 percent believe that penalties should be set as a percentage of profit or turnover.

- 2 Tightly defined harms make it easier to demonstrate and judge whether or not compliance has taken place:** Given the multifaceted nature of problems associated with global supply chains, it is appealing to design extremely broad laws capturing all possible negative impacts on people, flora, and fauna. However, experience to date suggests that the simpler and more tightly defined the harm to be avoided, the more likely a law is to be enforceable. More than 82 percent of respondents to the TREE Enforcement Survey agreed or strongly agreed that tightly defined harms make it easier to demonstrate and judge whether or not compliance has taken place. Furthermore, 79 percent of respondents tasked with enforcing the EUTR felt that Due Diligence

¹ The Forest Trends Timber Regulation Enforcement Exchange (TREE) process began in 2012 and facilitates a series of information-sharing workshops that bring together key stakeholders and enforcement officials for the US Lacey Act, the EU Timber Regulation, and the Australian ILPA. This dialogue has recently expanded to the Asia Pacific region, where a number of countries have new or developing timber trade regulations. Forest Trends continuously engages with members of the TREE network through surveys and other pieces of work to better understand the gaps and challenges in enforcing timber trade regulations.

² In August 2020, Forest Trends surveyed government agencies responsible for the enforcement of timber trade legislation for their views on what constitutes enforceable trade regulations. Through its TREE network, Forest Trends received 17 responses from 14 countries. The statistics mentioned in this paper include aggregated and anonymized results from 13 European countries (including the UK), and the US.



88% of survey respondents had sanctioned a company for failing to demonstrate compliance with harvesting laws, this figure dropped to 13% reporting sanctions relating to biodiversity conservation where directly related to harvesting or third parties legal rights concerning land tenure that are affected by timber harvesting.

is not defined clearly enough in the Regulation for inadequate risk assessment or mitigation to be subject to a penalty.

Compliance procedures in companies inevitably constitute a degree of degradation of any nuance intended in the legislation, as they will rely on available/actionable data, which is often limited and imperfect and companies may seek a minimum viable level of compliance. The scope of activity of enforcement agents is another level of degradation of any complexity, as they have to judge the quality of the information shared with them by companies, either voluntarily or under subpoena, and act in accordance with the mandate of their agency. Nuance invariably gets lost in this complex, sometimes adversarial, multi-actor process.

For example, the EUTR includes a broad scope of legality,³ but in practice, while 88 percent of survey respondents had sanctioned a company for failing to demonstrate compliance with harvesting laws, this figure dropped to 13 percent reporting sanctions relating to

biodiversity conservation where directly related to harvesting or third parties' legal rights concerning land tenure that are affected by timber harvesting.

FIGURE 1 Survey Responses from European Enforcement Officials Showing Their Most-Enforced Areas of Legality Under the EUTR

ANSWER CHOICES	RESPONSES
Rights to harvest timber	87.50%
Environmental legislation	62.50%
Requirements for a forest management plan	50.00%
Legal gazettelement of boundaries to the area in which the harvest took place	37.50%
Duties related to timber harvesting	37.50%
Requirements of export, insofar as the timber sector is concerned	37.50%
Payments for harvest rights	25.00%
Third parties legal rights concerning use of forest resources that are affected by timber harvesting	25.00%
Third parties legal rights concerning land tenure that are affected by timber harvesting	12.50%
Biodiversity conservation where directly related to harvesting	12.50%

Source: TREE Enforceable Supply Chains Survey, Forest Trends (2020).

³ Article 2 of the EUTR defines "legal" timber as any timber harvested in "accordance with the applicable legislation in the country of harvest". "Applicable Legislation" is defined as any legislation relating pertaining to: rights to harvest timber within legally gazetted boundaries, payments for harvest rights including any taxes or fees, any environmental or forestry regulation including biodiversity conservation where directly related to timber, third parties' legal rights concerning land use and tenure, and any trade and customs laws where the forest sector is concerned. Available: <https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:32010R0995>.



When asked why some elements of law have been less actionable under the EUTR, 54 percent of respondents selected “companies I check do not know the exact legal requirements that fall under these categories of legislation in their source countries/ supply chain,” and 46 percent stated the absence of data to demonstrate compliance with the legal requirements that fall under these categories of legislation in their source countries/ supply chains. A further 26 percent indicated that they had not been able to demonstrate a clear relationship between the single product line which officials have the power to check and compliance with all applicable legislation.⁴

Using this logic, legislation that aims to exclude illegal deforestation from supply chains, or restrict market access to “sustainably produced” commodities, is likely to be significantly more complex for companies to comply with at scale, or enforcement officials to act on. This is because information about the legality of land conversion is generally difficult to access/interpret, and sustainability remains a highly subjective balance of competing social, environmental, and economic priorities. Standards and data available for compliance with both types of legislation (legality or sustainability) are also highly contested. On the other hand, a regulation which aims to prohibit sourcing from areas that are subject to deforestation after a given cut-off date will be potentially easier to comply with using effective traceability systems and geospatial satellite data. It should be noted, however, that 47 percent of TREE Enforcement Survey respondents felt that illegal deforestation would be easier to define in a way that was enforceable, compared with just 29 percent who felt that deforestation after a cut-off point would be simpler in legal terms.

3 Laws that require some element of compliance to be demonstrated in the jurisdiction in which a case will be heard are much easier to prosecute: On first consideration, tackling negative consequences of global supply chains requires laws which reach into extraterritorial jurisdictional judgements. In the US, for example, the Lacey Act⁵ is well known for doing so. However, judgements of this sort are extremely difficult, politically and technically, for most courts to undertake without the active cooperation of the government in the country where the harm took place. Mutual Legal Assistance arrangements for collecting evidence in countries other than where a case will be heard are highly politicized, even for cases involving “global goods”; establishing the framework for international evidence collection has proven to be extremely challenging where the harm results in significant profits accruing to well connected individuals.

Enforcement officials and environmental prosecutors consistently report at TREE meetings that they have more faith in prosecuting laws which allow them to demonstrate compliance with, or failure to meet requirements to act in their home jurisdiction. For example, the US Lacey Act declaration requirement has been more fruitful in case number terms than the prohibition, as prosecuting the latter relies on an evidence base of both the initial infraction under foreign law and the specific journey taken by the product from place of harvest to the US border. The EUTR

⁴ Respondents were allowed to choose multiple responses so the total does not sum to 100 percent.

⁵ The Lacey Act is a 1900 United States law that bans the trafficking of illegal wildlife. In 2008, it was amended to include plant and plant products such as timber, pulp, and paper. The Act places a ban on the trading or trafficking of any forest product harvested in violation of the law and requires importers to file a declaration stating the product’s scientific name, the value of the importation, quantity of the plant, and the name of the country from which the plant was harvested. Importers who fail to comply with the declaration requirement, or knowingly provide false information can face civil or even criminal sanctions. For more, see: <https://www.regulations.gov/document?D=APHIS-2008-0119-0297>.



Due Diligence concept was designed in order to avoid this extraterritorial jurisdictional element, and the prohibition element of the law was subsequently added by the Parliament. After seven years in force, the prohibition element remains untried in court.

This suggests that laws which require companies to disclose information to their regulators that they can only have confidence in on the basis of effective traceability systems are more likely to be successfully enforced than laws which seek to define acceptable traceability systems, or rely on evidence of harms in commodity source countries (assuming that it is possible to validate the truth or otherwise of those disclosures by scientific or other methods). This approach also allows for the improvement of traceability systems over time.

4 Due Diligence does not mean “with documents”: The term Due Diligence is often misrepresented in practice. For example, a number of legislative initiatives in the Asia Pacific region require timber importers to present documentation purporting to demonstrate legal harvest at customs as “evidence of Due Diligence.” Its traditional legal sense is closer to “having gathered and considered all evidence necessary to be confident” and is very similar to the US Due Care concept, but it seems that levels of confidence in supply chains vary widely. This means that the legal construct has not established an effective level playing field, particularly in the EU, where Roman law systems tend to need significantly more prescriptive guidance than common law systems. Reflecting on the drafting of the EUTR and Lacey Act, over 88 percent of the TREE survey respondents agreed or strongly agreed that Due Diligence should not mean simply “with documents,” despite often being interpreted that way by both companies and courts.

Over 56% of enforcement respondents reported that they had reviewed DDS in which supply chain documentation could have been used multiple times in order to “launder” illegally sourced timber because there was no volume reconciliation available.

The broad variation in interpretation of the concept also leads to companies seeking only a “clean supply chain” through collection of documentary evidence, rather than a genuinely risk-free supply or supplier, which would require broader Due Diligence on all supplier inputs, outputs, and other activities. This leads to some suppliers using legitimate source documentation to “launder” orders of magnitude more product than the documents would legally allow, as there is no global system of volume reconciliation available to detect this fraud (Environmental Investigation Agency (EIA) 2012). Over 56 percent of enforcement respondents reported that they had reviewed Due Diligence systems in which supply chain documentation could have been used multiple times in order to “launder” illegally sourced timber because there was no volume reconciliation available. Furthermore, over 75 percent report that they are not aware of any Due Diligence tools in mainstream use which robustly tackle the risk of laundering through repeated use of “clean” documents.

In response to the EUTR, some timber companies have established internal systems to tally volumes with harvest permits over multiple harvest periods, but since they do not have access to information about all sources, or all other customers of the supplier, they cannot exclude the possibility that their peers are being reassured using exactly



the same harvest permits and related documents as evidence of legal source. There has also been a sharp increase in the use of scientific testing to challenge or authenticate the relationship between product and documentation on the part of both compliance and enforcement teams, in an effort to tackle document fraud.

This suggests that new legislation to tackle the trade in commodities should focus on validation of and purchase from larger units of supply than individual supply chains and require robust volume reconciliation in sections of supply chains, ideally with interoperability between traceability systems in order to deter such “laundering.” It also suggests that any scientific technique for establishing an objective relationship between product and source documentation that works with newly regulated commodities will be of great value (Saunders, forthcoming).

5 Perceptions of what constitutes “reasonable” behavior vary extremely widely: Since the concept of Due Diligence is based on the decision-making and actions of a “reasonable individual,” significant investment is necessary to establish a robust perception of acceptable norms on the part of key actors. For decades, it has been considered perfectly reasonable to buy products from countries where very challenging governance and absence of rule of law is the norm, with companies consistently seeking the cheapest raw materials and products without considering associated potential downsides. This has led to negative social and environmental consequences that many consumers and politicians are not happy with, yet there remains a gap in understanding of the direct relationship between constantly driving down prices and driving down standards. These processes do not have to be the same thing, but all too often they seem to be.

Practically, this variation in perceptions can be demonstrated by some but not all competent authorities for the EUTR requiring companies to translate documentation into the language of the importer/regulator while in another European Member State. Courts recently upheld a company appeal against a regulatory fine issued by the Competent Authority for repeated imports from the Congo Basin without application of a Due Diligence System on the grounds that the company staff cannot be expected to speak the language of the source country (French) or translate documents. Over 82 percent of TREE enforcement survey respondents agreed or strongly agreed that perceptions of what constitutes “reasonable” Due Diligence vary extremely widely among NGOs, companies, regulators, prosecutors, judges, and State.

Experience suggests that harmonizing interpretations of laws inside companies, regulators, and the judicial systems on which sanctions rely requires more than simply writing a law. Companies required to exercise Due Diligence need to be put on notice about risks and information about “reasonable” mitigation options needs to be actively developed and disseminated. Enforcement officials are consistently keen to see information about risk published and circulated within the business community so they can then be held accountable for considering it.

In the US, the Department of International Labor publishes annual lists of commodities and source countries where forced and child labor has been documented – an effective way to ensure that companies cannot dismiss information published by NGOs. By contrast, this approach has been



sorely lacking in the implementation of Section 54 of the UK Modern Slavery Act (MSA),⁶ under which companies continue to operate without accounting for risks that a cursory internet search review would make apparent. In line with the UK approach, EU institutions and Member States have been keen to avoid naming countries where buying illegally harvested wood is a significant risk, but have funded NGOs to undertake ad hoc investigations in key countries, and financed a global set of risk assessments using a consistent methodology by Nepcon, the first pan EU Monitoring Organisation recognised under the EUTR.⁷ The more specific, standardised, and formal information sources are, the more effective they are at driving companies away from plausible deniability and towards genuine compliance.

Any new legislation will need early investment in the communication of normative compliance resources in order to have maximum impact in a reasonable timeframe. While market leaders have established reasonable expectations in developing and communicating their voluntary commitments, significant segments of the market are likely to continue to fall outside these discussions. Unless it can be demonstrated in court that they have failed to act reasonably, experience from the enforcement of timber legislation suggests that their behavior is unlikely to change.

6 Enforcement officials need to be given proactive powers of investigation: To have maximum effect, laws need to be designed in a way that allows for proactive investigation and assessment rather than creating reactive accountability. While legal accountability for harms is obviously important, the resource and information asymmetry between a company and those that protect forests in source countries, not to mention the existential threats placed on front line defenders, means that active regulation is likely to be far more effective than a simple option for litigation based on the assumption that all are equal before the law. In the EU, the different mandates of regulators chosen by their national governments have a significant effect on the nature and extent of enforcement, often reflecting the extent to which they are able to inform and check companies and work with them over time to follow the development of compliance plans and implementation.

Information about product flows is key to effective risk-based enforcement. Regulators need access to information from both other agencies (e.g., customs) and companies/federations, as well as the powers and resources necessary to assess the legitimacy of that information. In the US, the Lacey Interagency Group has demonstrated that effective cooperation is critical to impact where multiple agencies are involved. Critical information sharing between EU Competent Authorities has also been hampered by data protection legislation.

⁶ The UK Modern Slavery Act is a 2015 Act of Parliament which consolidates a number of pre-existing anti-human trafficking, forced labor, and compulsory servitude laws, and creates new reporting obligations for UK Businesses. Section 54 of the Act requires all UK companies with an annual turnover of over GBP 36 million to post a statement, signed by a board member, to the front page of their website detailing all the steps taken that year to eliminate Modern Slavery from their domestic and overseas supply chains. It is important to note that Section 54 only obligates the reporting, it does not legally obligate companies to actually conduct any kind of Human Rights Due Diligence on their supply chains. For more, see Section 54: <https://www.legislation.gov.uk/ukpga/2015/30/section/54/enacted>.

⁷ A Monitoring Organization (MO) is a body that exists under the EUTR to assist operators in complying with the Regulation by supporting robust Due Diligence. According to the legislation, MOs must maintain, regularly evaluate, and verify a Due Diligence System (DDS) as set out by Article 6 of the Regulation and must allow operators the rights to use it. When applying for MO status, MOs must also agree to take appropriate action for failure on the part of the operator to properly use the system, including reporting any repeated compliance failures with the relevant Competent Authorities. For more, see Article 8: <https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A32010R0995>.



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- 7 Powers to tackle multiple points in the supply chain reduce the risk of circumvention:** The EUTR stands out as a weaker regime than the Lacey Act for its emphasis on regulating a single point in the supply chain, first placement on the Single Market. The decision, which was made on the grounds of minimizing the total bureaucratic burden on the timber trade, has pros and cons, the pro being that it allows Small and Medium Enterprises (SMEs) who do not have the resources to comply with the law to source through larger companies, offloading their regulatory burden on those that can afford it. On the negative side, it limits the scope of activity of enforcement to the Member State where the product was first placed, making the whole Single Market vulnerable to entry via low enforcement countries and undermining competition law.

A focus on importers also reduces/removes any potential positive synergies with reputational risk because most consumer branded companies can avoid responsibility for first placement on the market through the use of agents and middlemen. Legislators drafting future regulations should consider adding an element of responsibility on those actors further down the supply chain to ensure that they have not contributed to an offence prior to taking ownership of the product, with seizure or injunction on future sale as a potential penalty.

Over 76 percent of survey respondents agreed or strongly agreed that powers to require evidence of Due Diligence at multiple points in the supply chain would reduce the risk of circumvention within the EU.

- 8 Specialist prosecutors and judges have a critical role to play in effective adjudication of environmental cases:** There is a growing body of evidence to suggest that non-specialist prosecutors and courts/judges fail to grasp the complexity and importance of supply chain regulations for tackling genuine harms. Some EU Member States have competent authorities with mandates that include the ability to take cases directly to court, such as the UK, Sweden, and Netherlands, whereas others, for example, Germany, have to find prosecutors willing to take cases. Anecdotally, it appears that more cases have ended up in court in those countries where regulators have invested resources in becoming experts in the supply chains that they regulate and are able to move directly to prosecution based on their understanding of the merits of the case. Notably, the EUTR Competent Authority in the Netherlands, a leader in terms of the quality of cases and sanctions for non-compliant companies, has direct access to specialist environmental courts. In the TREE survey of enforcement officials, over 88 percent of respondents agreed or strongly agreed that specialist prosecutors and judges have a critical role to play in effective adjudication of environmental cases. Sixty-five percent report that they do not have access to specialist prosecutors, and 94 percent say they do not have access to specialist judges or courts.

Competent authorities have reported resistance from prosecutors to taking cases in a number of Member States and judge confusion about what constitutes reasonable behavior on the part of companies faced with the documented risks. Similarly, the first French Loi de Vigilance case



was handed down to commercial arbitration by a French court that declared itself not competent to make the necessary judgements about activities outside its jurisdiction. By contrast, the US prosecutors working on the Lacey Act are a small, highly specialised team who develop expertise by actively seeking information about source country risks and timber smuggling activities. While they do not have access to specialist environmental courts, this expertise allows them to directly inform and persuade judges of the merits of their cases, although total prosecution numbers remain limited.

- 9 Court issued financial penalties are not necessarily the only, or even best, option for tackling non-compliance:** In the EU, fines for non-compliance with the EUTR have been relatively low and courts have not generally appreciated the gravity of failing to meet its “bureaucratic” requirements, meaning that penalties have reflected the seriousness of failing to file documents appropriately rather than the seriousness of failing to protect forests.

While there has been one big ticket case against a timber importer under the US Lacey Act (United States Department of Justice 2016), it seems that the extremely high evidential threshold for these sorts of prosecutions is limiting their frequency and therefore their impact on the market. Under the EUTR framework, recourse to courts has also had less impact on market dynamics than other actions that directly target supply chains with the intention of disruption. For example, use of injunctions on sale have been effective in creating a sanction on companies with inadequate information about their wood, without creating the costs for regulators associated with prosecution or seizure followed by storage or disposal. In the case of imports of teak from Myanmar, a

statement that shipments would not be allowed to clear customs, but would instead have to be returned to source at the expense of the importer was significantly more effective than legal cases in reducing the volume of product imported in Germany and Belgium following the EU enforcement authorities and the European Commission (EC) common position on Myanmar teak, which concluded in 2018 that such imports could not comply with the requirements of the EUTR (Norman 2020).

There is a growing body of evidence to suggest that non-specialist prosecutors and courts/ judges fail to grasp the complexity and importance of supply chain regulations for tackling genuine harms.

This suggests that for most market impact, regulations to tackle the trade in commodities that threaten forests should focus on product relationships and allow for supply chain disruption or delay as an explicit sanction where companies fail to demonstrate that they have met requirements. This is in line with the US’ approach to exclude products made from forced and child labor from its market (Saunders 2020) and a reported keenness to increase use of forfeiture and seizure powers under the Lacey Act (in light of the lower evidential threshold necessary to achieve them).

- 10 Enforcement is only as strong as its weakest link:** No matter how well written, approaches to a law’s enforcement are critical to its impact. There is increasing evidence that some businesses and individuals will continue to seek out the weakest link in the enforcement chain to exploit it. Within the EU, circumvention via Member States with less effective enforcement has significantly undermined the effectiveness of the EUTR, despite significant efforts to negotiate “common



positions” of the EU28 on enforcement in particularly challenging supply chains (Norman and Saunders 2020).

Conclusion

The lessons from regulating the trade in illegal timber, combined with the responses to Forest Trends’ TREE enforcement survey, highlight a number of real and pressing challenges to establishing effective mandatory Due Diligence. They also however point to a number of specific and practical remedies. Tightly defined harms and guidance on what constitutes “reasonable” Due Diligence or care, robust penalties and other disincentives, addressing the weakest links in the supply chains and a reduction in barriers of inter-agency collaboration and information sharing (including amongst Member States) should be fundamental to the new laws if they are to stand any chance of significant and lasting efficacy.

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