

Draft EU Supply Chain Directive to further raise human rights and environmental standards

1.Introduction

In February 2022, the European Commission adopted its long-awaited proposal for a Directive on corporate sustainability due diligence [and amending Directive (EU) 2019/1937"; "EU Supply Chain Directive"). According to the draft, companies are to be obliged to carry out due diligence throughout their entire value chain and to include sustainability and human rights aspects in their business strategy. This is in line with the trend that has been going on for several years to no longer leave ESG issues to companies and consumers, but to establish binding regulations on human rights and environmental standards along global supply chains. In addition to the German Supply Chain Care Obligations Act ("Supply Chain Act") – which will come into force as early as 2023 – there are already supply chain laws in France, the Netherlands, Great Britain, Australia and the USA, for example. The planned EU Supply Chain Directive also applies to smaller companies, is intended to hold top management accountable and can lead to severe liability (fines and civil liability). Companies affected by the EU Supply Chain Directive should therefore prepare their business activities as well as their value chain for the EU Supply Chain Directive now. Although the EU Supply Chain Directive will not enter into force until 2024 at the earliest, the lead time until then is needed to take the necessary precautions within the company, otherwise there is a risk of civil liability, significant turnover-related fines and the exclusion of subsidies.

This article gives you an overview of the key points of the planned EU Supply Chain Directive that companies need to consider in relation to their global supply chains and explains how you can safely navigate this new legal framework and what you need to consider in order to prepare your company for the EU Supply Chain Directive now.

2.Objective

The proposal for a directive aims to enforce sustainable and responsible corporate behaviour in global value chains. Accordingly, the EU Commission's initiative pursues the goal of preventing negative effects on human rights and the environment in connection with the activities of companies, their subsidiaries and value chains.

3. Scope

The broad scope of the EU Supply Chain Directive is intended to apply to EU companies as well as to third-party companies offering their products and services in the EU. This is positive because the EU Supply Chain Directive thereby creates a harmonised legal framework in the EU that ensures legal certainty and a level playing field.

However, the draft also shows that the EU Supply Chain Directive will at the same time contain a much more restrictive regulation for companies in many areas than the German Supply Chain Act.

The new EU due diligence requirements apply accordingly to the following companies:

- Group 1: Large EU companies with at least 500 employees and a net turnover of at least EUR 150 million worldwide.
- Group 2: Other EU companies operating in certain resource-intensive sectors with more than 250 employees and a net turnover of at least EUR 40 million worldwide (these companies will be subject to the rules two years later than Group 1).
- Companies from third countries operating in the EU whose turnover in the EU is equivalent to that of Group 1 or Group 2.

The scope of the EU draft directive is correspondingly much broader than the scope of the German Supply Chain Act, which will come into force next year, according to which "only" companies with initially at least 3,000 and later 1,000 employees must meet certain due diligence obligations to protect human rights and environmental standards. According to an estimate by the EU Commission, around 13,000 EU companies and around 4,000 companies from third countries will be affected by the provisions of the EU Supply Chain Directive.

4.Value chain

In contrast to the German Supply Chain Act, the planned EU Supply Chain Directive does not "merely" cover the supply chains of companies, but also, through the use of the broader term "value chains", activities related to the production of goods or the provision of services by a company, including the development of the product or service and the use and disposal of the product, as well as the related activities of the upstream and downstream business relationships of the company.

5.Due diligence

In order to fulfil their due diligence obligations under the EU Supply Chain Directive, companies must, among others:

- make human rights and environmental due diligence an integral part of its corporate policy;



- carry out human rights and environmental due diligence,
- identify actual or potential negative impacts on human rights and the environment,
- prevent, remedy or minimise such negative effects on human rights and the environment,
- establish a complaints procedure for individuals, trade unions and NGOs affected by violations of human rights and environmental standards;
- carry out a regular evaluation (every 12 months or in the event of new risks) of their own activities, as well as those of their subsidiaries and the company's value chains, with regard to negative impacts on human rights and the environment;
- monitor the effectiveness of human rights and environmental due diligence measures;
- publish on its website an annual opinion on the issues covered by the EU Supply Chain Directive; and
- ensure that their business model and corporate strategy are compatible with the objective of combating climate change (including limiting global warming to 1.5°C in line with the Paris Agreement).

6.Fines, civil liability and exclusion of subsidies

The standards on corporate due diligence in the field of sustainability created by the EU Supply Chain Directive are to be enforced in particular through the following measures:

- Administrative supervision: Germany and the other EU Member States should designate a national authority responsible for monitoring and imposing effective, proportionate and dissuasive sanctions, including turnover-related fines, and for measures to comply with the EU Supply Chain Directive. For a harmonised application of the EU Supply Chain Directive, a European network of supervisory authorities is to be set up to ensure coordinated action across the EU. Decisions of the national supervisory authorities against companies concerning sanctions in connection with infringements of the provisions of the EU proposal for a directive are to be published (naming and shaming).
- Civil liability: In contrast to the German Supply Chain Act, the EU Supply Chain Directive is intended to provide for independent civil liability: Germany and the other EU member states must accordingly ensure that those affected are compensated for damage caused by non-compliance with the obligations of the EU Supply Chain Directive. However, companies can reduce their liability risk by trying to prevent potential negative impacts on human rights or the environment or by remedying actual negative impacts in a timely manner. According to the otherwise applicable national tort law, companies in most constellations are not yet liable for the misconduct of third parties in their supply chain.
- Exclusion of public subsidies: Finally, EU Member States should ensure that companies applying for public funding certify that they have not been sanctioned for failing to comply with their obligations under the EU Supply Chain Directive.

7.Responsibility of management



The EU Supply Chain Directive involves executives (including management, managing directors, board members and supervisory boards) in the responsibility under the EU Supply Chain Directive to ensure that human rights and environmental (including climate protection) due diligence obligations – as defined in the EU Supply Chain Directive – become part of the corporate strategy. Therefore, the EU proposal obliges managers to ensure the implementation and monitoring of due diligence obligations under the EU Supply Chain Directive and the integration of sustainability efforts into the corporate strategy. Germany and the other EU Member States must also ensure that their legislation on breaches of the legal obligations of managers also applies to breaches of these standards of the EU Supply Chain Directive.

8. How can companies prepare for the new EU Supply Chain Directive?

The EU Supply Chain Directive must first be adopted by the EU and then transposed into national German law. However, it can be firmly assumed that the EU Supply Chain Directive will be adopted in the near future and will lead to an amendment and tightening of the German Supply Chain Act due to its stricter regulations. As a first step, it is therefore advisable for companies to implement the standards of the German Supply Chain Act, which will come into force in 2023, in a timely manner in order to prepare for the upcoming EU Supply Chain Directive and thus at the same time increase their own value and reputation as an ESG-compliant company, but also as a reliable partner for business partners. Companies are also recommended to establish a binding Code of Conduct, to adapt their value chains and their supply contracts (including termination rights, exemption clauses, contractual penalties and information claims regarding the subsequent supply chain) and to pay more attention to their reliability and the purchasing countries when selecting suppliers. Finally, companies should conduct due diligence on their existing global supply chains for possible violations of human rights or environmental standards, and in particular take a close look at new suppliers.

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