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Arbitrating Contractual Disputes Over Corporate Sustainability

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Arbitrating Contractual Disputes Over Corporate Sustainability

Maria Fogdestam Agius
Westerberg & Partners Advokatbyrå AB

Summary

IN SUMMARY

The proposed Corporate Sustainability Due Diligence Directive will compel companies to seek contractual assurances from business partners to comply with codes of conduct and international human rights norms. Where suppliers cause or contribute to adverse human rights impacts in the supply chain, companies may be required to respond by suspending or terminating the business relationship. As this right may be contentious, a new class of commercial disputes addressing alleged corporate human rights infringements is likely to emerge. When such disputes come before arbitral tribunals, this presents new challenges for international commercial arbitration.

DISCUSSION POINTS

- Corporate responsibility to respect human rights
- European Union legislation on corporate sustainability
- Supply chain due diligence
- Enforcement of human rights through supply chain arbitration
- Drafting arbitration clauses for ESG disputes
- Challenges for arbitration in commercial cases involving human rights

REFERENCED IN THIS ARTICLE

- Corporate Sustainability Due Diligence Directive
- United Nations Guiding Principles on Business and Human Rights
- OECD Guidelines for Multinational Enterprises on Responsible Business Conduct
- OECD Due Diligence Guidance for Responsible Business Conduct
- Model Contract Clauses for Human Rights Project of the American Bar Association
- Hague Rules on Business and Human Rights Arbitration

INTRODUCTION

That corporations should conduct themselves in a socially responsible way is not a new idea.[1] But in the past decade, this expectation has been more distinctly expressed through international standards, ratings, and management systems to address environmental, social and governance (ESG) issues.[2] Compliance with such standards and systems is now a matter of corporate reputation and identity, reinforced by public pressure and statutory requirements to disclose sustainability datapoints in annual reports.[3] Over time, the notion has taken hold that there exists a social contract between a company and societies affected by its operations, and that companies must respect the basic human rights of people living in those societies.

In the European landscape, the contour of this social contract is slowly but surely turning into black letter law. Since around 2017, a number of European countries have passed domestic legislation compelling companies to exercise mandatory vigilance, due diligence or

transparency with respect to human rights impacts in their operations and in the operations of those with whom they do business.[4]

The European Union (the EU) started taking steps towards unified legislative action on mandatory human rights due diligence across the European market in 2020, citing the need for harmonised rules. Following extensive research and public consultation,[5] the European Commission (the Commission) in February 2022 presented a proposal for a Corporate Sustainability Due Diligence Directive (CSDDD).[6]

The legislative process has been anything but straightforward. The Commission proposal drew heavily on non-binding United Nations (UN) and Organisation for Economic Co-operation and Development (OECD) standards.[7] In November 2022, the Council of the European Union (the Council) presented its negotiating mandate, introducing substantive revisions aimed at easing the burden on companies.[8] In June 2023, the European Parliament (EP) adopted its amendments, adding further concepts borrowed from the United Nations Guiding Principles on Business and Human Rights: Implementing the United Nations 'Protect, Respect and Remedy' Framework (UNGP) and OECD Guidelines and seeking to broaden the circle of companies to which the Directive would apply.[9] Following so-called trilogue negotiations between the EU legislative bodies, the Council and the EP agreed on a text in December 2023.[10] In early 2024, this was subject to turbulent negotiations[11] and further adjustments.[12] A revised version was approved by the Council in March 2024 and by the European Parliament in April 2024. It was finally adopted and passed by the Council in May 2024 (the Directive).[13]

Critics of the CSDDD expressed concern about, inter alia, the effect on competitiveness in global markets, fearing that small and medium-sized enterprises (SMEs) might be excluded from supply chains within the EU.[14] The Directive's approach to fostering sound, responsible, sustainable and rights-compatible business practices throughout global supply chains is focused on enforcement of human rights expectations in the relationship between commercial actors. It requires companies in scope to undertake due diligence in respect of both their own operations and their supply chains to identify, prevent and mitigate actual and potential adverse impacts on human rights or the environment. In addition to scrutinising the sustainability of suppliers' activities, companies will be obligated to seek contractual assurances from suppliers that they will comply with corporate codes of conduct or relevant international human rights norms. In addition, companies in scope may need to ask their suppliers to demand the same assurance from their business partners to the extent that they contribute to the same 'chain of activities'.[15] This amplifies the commitments to human rights throughout the supply chain.

As compared with the initial proposal, the finally agreed text significantly reduces the Directive's scope by raising the thresholds at which companies must abide by the CSDDD, doubling that for size and tripling that for turnover. It also appears to limit the due diligence duty to relationships with partners that carry out activities for the company or on behalf of the company, which could eliminate sub-suppliers.[16]

The Directive will come into force 20 days later after publication in the Official Journal of the European Union. This will trigger the period in which EU member states must transpose the Directive into national law and begin its phase-by-phase implementation.

Some companies have already for years placed on their suppliers the kind of demands envisaged by the Directive, conforming with the due diligence recommendations of the UN

and OECD standards. The warning of forthcoming legislation may further have incentivised companies to adapt their practices, and many companies have indeed expressed their support for the CSDDD. The reporting obligations in the Corporate Sustainability Reporting Directive, imposed on many EU companies as of 5 January 2024, further compels companies to review their practice. As a result, clauses on human rights compliance and ESG issues will likely be included ever more frequently in commercial contracts.

However, just like any other contract term, the interpretation or application of such clauses may be contentious. Where contracts refer parties to arbitration to settle differences arising under the contract, it may be for arbitral tribunals to consider what, precisely, international human rights law demands of companies to fulfil their ESG commitments, and to assess whether human rights have been or are at risk of being infringed by corporate conduct in a particular case. This will likely give rise to new challenges for commercial arbitration.

This article reviews the implications that the proposed EU legislation on corporate human rights due diligence could have for corporate supply chain management and the resolution of ESG-related disputes within the supply chain.

What follows is a brief overview of the key features of the CSDDD, what this may mean for how companies draft their contracts and prepare for eventual disputes arising over ESG compliance, and how international arbitration may be adapted to fit the particular challenges imposed by ESG disputes.

EUROPEAN CORPORATE HUMAN RIGHTS DUE DILIGENCE

The corporate duty to undertake human rights and environmental due diligence, as set out in the CSDDD, requires companies to address actual harm, and to identify risk of harm, in the activities of the company itself, its subsidiaries and its business partners that contribute to the company's products or services.

Due Diligence Policy And Processes

Companies should have in place a due diligence policy that describes the company's approach to due diligence and the code of conduct it expects employees and subsidiaries to follow. The policy should also account for the measures it takes to verify compliance with the code of conduct and extend its application to its business partners. Due diligence should be integrated in all relevant corporate policies and risk management systems.[17]

Companies should map operations to identify the areas where risks are most likely and severe and carry out in-depth assessment in those areas.[18] In doing so, they should consider the inherent risk factors relating to their sector, products or services; where activities in their chain are geographically located; and contextual risk factors such as the level of law enforcement in those locations, the character of their business operations and the circumstances of other companies involved in the chain, in particular whether they themselves fall under the CSDDD.[19] Relevant operations should be reviewed periodically and at least annually, but assessments should also be renewed when there are indications of ongoing impact, new risks of adverse impacts arising or some significant change in circumstances (ie, on a continuous, iterative and risk-based basis).[20]

Companies should also have in place complaints procedures available to affected persons, workers' representatives and concerned civil society organisations.[21] This provides a remedy for affected stakeholders, but it is also an important source of information about potential impacts.

Where certain information cannot be obtained, companies should be able to explain why this is so and should take reasonable steps to obtain the information as soon as possible.[22]

Addressing Potential And Actual Impacts

If a potential impact is identified, companies should take appropriate measures to prevent the impact from materialising. Where prevention is not possible, the company has a responsibility to mitigate the impact as far as possible.[23] If an impact has already occurred, companies must take appropriate measures to bring it to an end. Where this cannot be done, there is a duty for the company to act to minimise its extent.[24]

Companies should monitor that preventive or corrective measures are taken and correctly implemented so that adverse impacts are indeed avoided, ended or mitigated.[25]

The appropriate measures to take to prevent or end an impact will depend on a number of factors. First, it will depend on the nature of the company's level of involvement with the impact.[26] Where a company has caused, alone or jointly, an actual adverse impact, it shall provide remediation to affected individuals and entities.[27] Where the impact or risk of impact is caused by a business partner, the appropriate action will depend on whether the company is in a position to influence the conduct of the business partner that causes or contributes to the potential impact.[28] Second, the appropriate measures will depend on whether the impact is likely to occur within the operations of the company itself or in the operations of a subsidiary or direct or indirect business partner.[29] Third, the appropriate action may also depend on some of the same individual factors that informed the design of the due diligence process, such as the characteristics of the sector and the nature of the activities, products and services.[30]

In addressing risks and impacts, companies may have to make priorities. One should start with the most severe impacts.[31] Severity is judged based on the gravity of the impact (scale), the number of affected individuals (scope) and the limitations on the ability to restore the situation to that preceding the impact (irremediability or irreversibility).[32] Together with the likelihood of an identified risk, the severity of the actual or potential impact is therefore a key factor to determine the appropriate action to take in response.

Scope Of Application

Setting up and implementing a due diligence process will inevitably impose administrative burdens on companies. This has caused considerable political debate over the scope of the CSDDD.

The Directive will apply only to larger companies,[33] and only a fairly slim percentage of companies will fall within the scope.[34]

The CSDDD is envisaged to apply also to non-EU companies, subject to certain levels of net turnover being generated in the EU.[35]

Despite the limited scope, SMEs within and outside the EU may come to feel the effects of the CSDDD if they are business partners or belong to the chain of activities of companies in scope. In response, the Commission has proposed that both member states and companies partnering with SMEs should support SMEs in fulfilling due diligence requirements, including financially.[36]

The Commission proposal applied only to 'established' business relationships, in the sense of lasting commercial relationships that represent more than an ancillary part of the value chain.[37] The EP wanted to widen the scope by omitting the qualifier 'established'. The Council introduced the term 'business partner', a term retained in the final Directive.[38] This term incorporates both direct and indirect business partners.

The main focus is upstream due diligence: upstream business partners are part of the chain of activities if their operations relate to the company's production of goods or provision of services. This would require companies to review, in particular, their purchasing practices and consider, for example, how they contribute to living wages and incomes for employees associated with suppliers. By contrast, downstream business partners are included only to the extent that they carry out activities for distribution, transport, storage and disposal of goods directly or indirectly for the company or on behalf of the company. Business partners that receive a company's services are not included.[39] Consistently with this, the financial services sector is excluded from the scope of the Directive.[40] However, the proposal includes a review clause for future inclusion of this sector, subject to further impact assessment.[41]

Finally, as regards the substantive scope, the draft CSDDD lists in an annex a number of specific human rights that companies must respect and which their due diligence should cover.[42] In addition, due diligence should cover impacts that affect rights protected in separately listed human rights instruments, if the company could have reasonably foreseen the risk of human rights abuse,[43] and adverse environmental impacts resulting from the violation of prohibitions and obligations in a number of listed multilateral environmental agreements.[44]

IMPLICATIONS FOR CORPORATE VALUE CHAIN MANAGEMENT

The focus on value chain management derives from the EU market's link to millions of workers around the world through global supply chains.[45] The management model has a significant contractual component: the Directive prescribes various means to improve companies' control over their suppliers, such as a duty to impose codes of conduct on suppliers wherever possible, a requirement to have in place mechanisms for monitoring the conduct of business partners through audits and risk assessments, an expectation that contractual partners act loyally and supportively to enable the other party to meet human rights commitments, and a right and duty to suspend or terminate a contract for lack of expected human rights protection and failure to correct conduct that leads to human rights risk or infringement.

Assessing And Engaging With Business Partners On Corporate Conduct

Companies are expected to review how their business partners operate, when it relates to the company's chain of activities. This includes assessing their business model and strategies, including trading, procurement and pricing practices.[46]

Where human rights risks or impacts are identified, companies should seek to neutralise any ongoing impacts as far as possible, develop an action plan and seek contractual assurances from its business partners that they will comply with the plan. Companies should also make any necessary additional adjustments to their own business model, practices and processes.[47] Furthermore, the Directive encourages companies to engage with their business partners, more generally.[48] This involves seeking to persuade the business partner in question, leveraging the company's market power, using pre-qualification requirements or

linked business incentives, or cooperating with other actors involved with the same business partner to increase leverage.[49]

Seeking Contractual Assurances From Business Partners

The obligation to seek contractual assurances applies in relation to business partners with whom there is a direct commercial relationship. In practice, companies often request suppliers to commit to complying with their code of conduct. The CSDDD makes this practice obligatory and requires companies to seek more specific commitments to preventive or corrective action plans specifically tailored to identified risks or impacts that could not be prevented.[50] Compliance with contractual assurances may be monitored with the help of third-party audits – a feature that may helpfully be regulated in the contract.[51]

Contractual assurances should be designed to ensure that responsibilities are shared appropriately by the company and the business partners.[52] Model clauses are available to draw on,[53] and further guidance can be expected from the EU in due course.[54]

However, model clauses should be tailored to the specific circumstances. The diverse nature of ESG-related risks across regions and sectors may require different approaches to risk management, which should be reflected in contracts with suppliers. The characteristics of the contractual partner will also differ, for example with respect to their previous experience of ESG certifications and audits.

Where a supplier is an SME, this may require further adaptation. The Directive prompts companies to use fair, reasonable and non-discriminatory terms when imposing contractual terms on SME partners.[55] In the event of identified risks and impacts, companies may be required to provide targeted and proportionate support for an SME business partner where necessary in light of the partner's resources, knowledge and constraints.[56]

Companies should also ask business partners to seek corresponding contractual assurances from sub-suppliers for operations that relate to the company's chain of activities.[57] In addition, a company could seek separate contractual assurances from an indirect business partner to comply with the company's code of conduct or a preventive or corrective action plan.[58] This feature may effectively extend the requirements under the Directive to suppliers outside the Directive's scope, both within and outside the EU, who will otherwise run the risk of being excluded from the supply chains of companies falling under the Directive.

Increasing Leverage Through Contract Terms

Companies are thus obliged to seek but not to obtain contractual assurances. Obtaining them may depend on the circumstances.[59] The ability to impose ESG clauses and conditions under a contract, or to get a separate ESG compliance agreement in place with an indirect business partner, will likely be a factor of the commercial relationship and the weight that the respective parties attach to it.

However, while the amount of leverage that a company exercises in its supply chain can determine how it may best take effective corrective measures, it does not determine the degree to which a company is required to act in response to an impact. Priorities should be set based on the severity and likelihood of the impact.[60] Where there is little leverage, the appropriate measure in response to an identified risk or impact may be to increase one's leverage, if possible.[61]

The Directive proposes, for example, that companies should collaborate (within the confines of competition law) with other entities to prevent, mitigate, end or minimise a potential or actual impact.[62] Where there is no prospect for the company to get a separate assurance from a sub-supplier, collaboration with companies that have more leverage over that entity may help compel an indirect business partner to take preventive or corrective action.[63]

Once a company has managed to impose contractual conditions on a business partner, that in itself considerably increases its leverage. In particular, this will be the case if the company has secured for itself a right under the contract to suspend or terminate the contract for ESG-related reasons.[64] Where the law governing the contract allows it – and member states must ensure that their laws do allow it[65] – companies may be required to react to a potential or actual impact by suspending the business relationship as a means of increasing their leverage over their business partner.[66] Suspension is to be combined with the implementation of an enhanced preventive or corrective action plan, during the timeline of which the company could look for alternative business partners.[67]

Disengaging With Suppliers

Where a business partner causes or risks causing an adverse impact that cannot be prevented, mitigated, ended or minimised, the Directive requires companies to refrain from entering into new relations with that partner or extending the existing relationship.[68] If the impact is severe, companies should consider terminating the relationship, if the action plan fails to prevent or correct the impact.[69]

Disengagement with a supplier, however, is a last resort. Before terminating a relationship, companies should assess whether the adverse impacts of termination could be manifestly more severe than the adverse impact that termination seeks to address.

Contractual Remedies

It is helpful, and arguably more impactful, if remedies such as suspension and termination are spelt out in the contract itself. The requirement to suspend or terminate relationships in situations where efforts of prevention and correction are failing is also in keeping with international soft law standards such as the UNGP, and it is likely that the obligation for companies to distance themselves from business partners that fail to correct human rights issues in their operations will be applied in keeping with these international guidelines. Arguably, companies will be obliged to exercise rights of suspension or termination where available, whether they are written into the contract or not. But because the practicalities of doing so are rarely straightforward, it is better to regulate the situation ahead of time, where possible.

Companies may also wish to consider regulating issues of liability and indemnity, for example to cover fines the company may be ordered to pay because of adverse human rights impacts in its value chain or delays in its own production caused by suspension of a supplier relationship.[70]

RESOLVING SUPPLY CHAIN DISPUTES THROUGH ARBITRATION

Because of the effect on a company's leverage, the CSDDD essentially makes it obligatory to try to negotiate a new class of commercial terms to be included in various business contracts, including supply agreements or joint venture agreements. In practice, such clauses could impose a range of different obligations, such as disclosure and reporting commitments, benchmarks, compliance assurance or other specified targets on ESG issues.

They may, and arguably should, set out various consequences to be applied if such obligations are not met.

Potential For Disputes Over ESG Contractual Requirements

However, such clauses may give rise to disputes. Parties may disagree on, for example, whether a party as a matter of fact has complied with a mandatory code of conduct, whether it has acted with due diligence to avoid infringing on human rights, whether it has misrepresented ESG matters to its counterpart, whether it has in fact caused or contributed to an actual or potential human rights impact, and indeed whether it has received adequate support from its business partner to enable it to comply.

A party whose reputation has suffered from events in its value chain, causing it to lose customers or be excluded from business relationships or projects, may have claims to lost profits. In another scenario, the company may experience delays in its production or delivery because of the need to remove suppliers or sub-contractors, halt projects or undertake investigations.

Such claims may need to resolve differences over the interpretation of human rights clauses in contracts, the effects of CSDDD as mandatory law to international arbitrations, distribution of the transaction cost of complying with ESG obligations, the role of third-party conduct, evidentiary issues and, last but not least, causality. It may be contentious whether the business partner as a matter of fact has at all engaged in the conduct of which it is accused, whether an impact is severe enough to warrant termination under the contract or whether termination in fact gives rise to more severe adverse impacts.

This leads to an emerging new class of ESG-related commercial disputes, marked by their significant human rights component.

Resolving ESG Disputes Through Arbitration

Where contracts incorporating a contentious ESG clause also contain an arbitration clause, parties will need to submit their ESG dispute for arbitration.

Arbitration can indeed be a viable way to resolve such disputes. In particular, where supply chains are global or transboundary, international arbitration may be preferable to domestic litigation.[71]

Other desirable features include the choice as to the level of confidentiality and transparency and the ability to select decision makers.[72] Disputes that involve allegations of human rights abuse could have a seriously damaging effect on a company's reputation.[73] It may also require from counsel and arbitrators particular expertise in human rights law and relevant business and human rights standards and guidelines. Arbitrators may need to decide whether a particular conduct is in fact impacting a human right, what the respect for human rights means in a corporate context and how far the obligation to use or increase leverage over suppliers extends.

Arbitration clauses in commercial contracts could usefully be drafted in a way that foresees dealing with claims that carry a human rights dimension. For example, parties may choose to submit ESG-related disputes with suppliers to arbitration under the Hague Rules on Business and Human Rights Arbitration (the Hague Rules). While preserving party autonomy in appointing arbitrators based on the expertise needed in each case, the Hague Rules provide that the presiding or sole arbitrator in cases involving business and human rights

should have demonstrated expertise in business and human rights law and practice, in addition to the relevant national and international law and knowledge of the relevant field or industry.[74]

Arbitration under the Hague Rules thus increases the likelihood that the dispute is heard by an arbitrator who understands well the human rights law that underpins a contractual dispute over the application of the ESG clause. A reference in the contract to the Hague Rules may signal commitment to giving full effect to the ambition of applying the contract with due regard to the human rights of affected stakeholders. It may arguably even be a way to increase leverage over a supplier, who will then have to assume that the human rights issues will be given due effect in dispute resolution over the contract.

Parties anticipating ESG disputes may also wish to adapt commercial dispute resolution clauses to accommodate the complexity of supply chain disputes. If due diligence and contractual assurances involve multiple tiers, an eventual dispute is more likely to involve multiple tiers of suppliers. It is wise to consider addressing in the arbitration clause the potential for multi-party arbitrations, consolidation and joinder.[75]

It may also be useful to supplement the arbitration clause with relevant reference to, for example, the IBA Rules on the Taking of Evidence in International Arbitration, for further clarity on, for example, document production. Obtaining and substantiating information needed for a contentious dispute may be more complex in an ESG context.

CONCLUSIONS

The CSDDD will likely foster more forceful supply chain management and increase the corporate respect for human rights.[76] For some companies, the Directive will confirm business practices that they have already implemented in their organisations. For others, these requirements will require extensive changes in the way business is done and the way supply chains are managed. In any event, replacing soft law standards with black letter law tends to affect the urgency with which companies comply.

The type of contractual terms envisaged in the Directive may give rise to disputes between contractual partners over the precise interpretation of obligations, the degree of compliance, or the allocation of responsibility for a potential or actual impact. Where such disputes are submitted for arbitration, arbitral proceedings may need to address the tension between assessing an alleged human rights infringement (not in itself a dispositive contractual issue) and the contract interpretation issues that is the staple of commercial arbitration (eg, the allocation of liability; the additional costs to arise for the contracting parties due to suspensions, delays and replacement sourcing; and the quantum of reputational damage linked to a counterpart's human rights infringement). It is also possible that litigation or arbitration finance will be available only once more jurisprudence on ESG disputes becomes available.

Further guidance on a number of issues is needed and is indeed likely to emerge in the coming years. The Directive anticipates that the Commission will issue guidelines for specific sectors or specific adverse impacts, incorporating due diligence guidance from the OECD and the UNGP. Such guidance could include lists of risk factors; sector-specific guidance; information on conflict-sensitive, gender-responsive and culturally responsive due diligence; guidance on information sharing and resource pooling in compliance with competition law; information on how to establish operational-level grievance mechanisms and how to engage with affected stakeholders; guidance on responsible disengagement, how to apply

prioritisation strategies and proportionality in relation to due diligence, access to justice for victims and responsible purchasing practices; and information for EU export credit agencies to help EU and member states' funds and export credits operate in line with the principles of the Directive.

ESG disputes are likely to remind us that supply chain due diligence is ultimately a qualitative exercise that is meant to effectuate change. Disputes will arise where risk is intolerable, where infringements do happen and go uncorrected, and these will be instances where people's lives are affected in an unacceptable way. This is ultimately where any form of justice needs to be dispensed, and where it will do service to society.

Companies will have their own reasons to wish to police human rights issues in the supply chain, beyond securing their reputation with consumers. The proposed unified EU rules will help level the playing field and ensure harmonised rules across the EU.[77] Universal compliance will avoid putting a premium on due diligence, help share the cost of ensuring a compliant supply chain and avoid unwanted effects on competitiveness.[78] The CSDDD, and the prosecution of proceedings against business partners failing to comply, may therefore ultimately be in the interest of business, too.

Endnotes

1 The term 'corporate social responsibility' was coined by American economist Howard Bowen in his 1953 publication ***Social Responsibilities of the Businessman***. ^ Back to section

2 See United Nations Guiding Principles on Business and Human Rights: Implementing the United Nations 'Protect, Respect and Remedy' Framework, endorsed by the Human Rights Council through Res. A/HRC/RES/17/4, 6 July 2011 (the UNGP); see also OECD Guidelines for Multinational Enterprises on Responsible Business Conduct, last updated in 2023 (the OECD Guidelines) and OECD Due Diligence Guidance for Responsible Business Conduct, 2018 (the OECD Due Diligence Guidance). These standards are complemented by an 'ESG investment ecosystem', including ESG ratings that provide an opinion on the exposure of a company or entity to ESG factors, and their impact on society. See the EU Proposal for a Regulation of the European Parliament and of the Council on the transparency and integrity of Environmental, Social and Governance (ESG) rating activities, 2023/0177 (COD), 13 June 2023. ^ Back to section

3 See Directive (EU) 2022/2464 of the European Parliament and of the Council of 14 December 2022 as regards corporate sustainability reporting (the Corporate Sustainability Reporting Directive); see also Directive 2014/95/EU of the European Parliament and of the Council of 22 October 2014 as regards disclosure of non-financial and diversity information by certain large undertaking and groups. ^ Back to section

4 See, for example, Loi relative au devoir de vigilance (Duty of Vigilance Law), France (2017); Forbrukertilsynet (Transparency Act), Norway (2022); Lieferkettensorgfaltspflichtengesetz (Supply Chain Due Diligence Act), Germany (2023). Multiple states have legislation proposals under way. ^ Back to section

5 See Study on due diligence requirements through the supply chain, Final report by the British Institute for International and Comparative Law, Civic Consulting and London School of Economics for the European Commission, January 2020; European Commission, Directorate-General for Justice and Consumers, Study on directors' duties and sustainable corporate governance, Final report by Ernst & Young, July 2020; see also the open public consultation on a sustainable corporate governance initiative launched by the European Commission in October 2020. ^ Back to section

6 Proposal for a Directive of the European Parliament and of the Council on Corporate Sustainability Due Diligence and amending Directive (EU) 2019/1937, COM/2022/71, 2022/0051(COD), Proposal by the European Commission, 23 February 2022 (Commission Proposal). ^ Back to section

7 See Commission Proposal, recitals 5–6 (referencing the standards cited above in footnote 2). The basic structure and conceptual framework of the Directive is clearly inspired by these standards. ^ Back to section

8 Proposal for a Directive of the European Parliament and of the Council on Corporate Sustainability Due Diligence and amending Directive (EU) 2019/1937, 2022/0051(COD), General Approach of the Council of the European Union, 30 November 2022 (Council Mandate). ^ Back to section

9 Proposal for a Directive of the European Parliament and of the Council on Corporate Sustainability Due Diligence and amending Directive (EU) 2019/1937, 2022/0051(COD), Amendments adopted by the European Parliament, 1 June 2023 (EP Mandate). ^ Back to section

10 Corporate sustainability due diligence: Council and Parliament strike deal to protect environment and human rights, Press Release, Council of the European Union, 14 December 2023. The text was released in January 2024. See Proposal for a Directive of the European Parliament and of the Council on Corporate Sustainability Due Diligence, 2022/0051(COD), Draft Agreement, 24 January 2024 (Draft Agreement). ^ Back to section

11 At a vote on 28 February 2024, 13 countries reportedly abstained, and one country (Sweden) voted no. See Huw Jones, 'EU Softens Crackdown on Child Labour, Pollution in Supply Chains', ***Reuters***, 6 March 2024, available at https://www.reuters.com/sustainability/society-equity/eu-softens-crackdown-child-labour-pollution-supply-chains-2024-03-06/. On 8 March 2024, a revised proposal equally failed to get the necessary support. See Michael Hurley, 'Key Vote on CSDDD delayed again', ***Environmental Finance***, 8 March 2024, available at https://www.environmental-finance.com/content/news/key-vote-on-csddd-delayed-again.html. ^ Back to section

12 In early March 2024, the EU presidency worked out a further compromise, in an effort to get the proposal approved. ^ Back to section

13 See the letter from the General Secretariat of the Council to the chair of the JURI Committee of the European Parliament regarding Proposal for a Directive of the European Parliament and of the Council on Corporate Sustainability Due Diligence and amending Directive (EU) 2019/1937, 2022/0051(COD), 15 March 2024; European Parliament legislative resolution of 24 April 2024 on the proposal for a directive of the European Parliament and of the Council on Corporate Sustainability Due Diligence and amending Directive (EU) 2019/1937, COM(2022)0071, C9-0050/2022, 2022/0051(COD), 24 April 2024; Corporate sustainability due diligence: Council gives its final approval, press release, Council of the EU, 24 May 2024. ^ Back to section

14 See 'EU fails to pass law requiring human rights and environmental audits on Chinese suppliers', ***South China Morning Post***, 28 February 2024, available at https://tinyurl.com/ycxy5d6v. ^ Back to section

15 The Directive refers to a company's 'chain of activities', rather than 'supply chain' or 'value chain'. The 'chain of activities' refers to 'activities of a company's upstream business partners related to the production of goods or the provision of services by that company, including the design, extraction, sourcing, manufacture, transport, storage and supply of raw materials, products or parts of products and the development of the product or the service'. See Directive, article 3(1)(g)(i) and recital 18. ^ Back to section

16 See Huw Jones, 'EU Softens Crackdown on Child Labour, Pollution in Supply Chains', Reuters, 6 March 2024 (cited above in footnote 11). ^ Back to section

17 Directive, article 7. ^ Back to section

18 Directive, article 8. ^ Back to section

19 Directive, article 3(1)(u); see also recital 41. ^ Back to section

20 Directive, article 15. ^ Back to section

21 Directive, article 14. ^ Back to section

22 See Directive, recital 40. ^ Back to section

23 Directive, article 10. ^ Back to section

24 Directive, article 11. ^ Back to section

25 Directive, article 15. ^ Back to section

26 Directive, articles 10(1)(a) and 11(1)(a); see also recital 53 (which reiterates the distinction between different involvement terms reflected in the UNGP). ^ Back to section

27 Directive, article 29. Under the UNGP, a failure to carry out adequate due diligence can be seen as a contributing factor to an adverse impact, if the passivity enables, encourages, facilitates, incentivises or motivates a supplier to cause an adverse impact. This would not appear to be the case under the CSDDD. Article 29 provides that the failure to undertake due diligence is a factor relevant for civil liability but also states that a company cannot be held liable for damage caused by a business partner in its chain of activities. ^ Back to section

28 Directive, articles 10(1)(c) and 11(1)(c). The draft Directive provides in articles 10 and 11 for a series of measures to take in this respect, further described below. ^ Back to section

29 Directive, articles 10(1)(b) and 11(1)(b). ^ Back to section

30 Directive, article 3(1)(o) and (u). ^ Back to section

31 See Directive, article 9. ^ Back to section

32 See Directive article 3(1)(l). ^ Back to section

33 The final Directive applies to companies with more than 1,000 employees and €450 million turnover. Earlier proposals for size of the company have ranged between 250 and 5,000 employees and, for turnover, as little as €40 million has been proposed in the past. ^ Back to section

34 SMEs make up 99 per cent of the companies within the EU, meaning that only 1 per cent would fall under a due diligence duty under the CSDDD. Under the more inclusive original proposal, the Directive was expected to apply to some 13,000 EU companies. See Commission Proposal, p. 16. ^ Back to section

35 See Directive, article 2(2). Under the more inclusive original proposal, the Directive was expected to apply to some 4,000 third-country companies. See Commission Proposal, p. 16. ^ Back to section

36 Directive, articles 10(2)(3) and 11(3)(f). ^ Back to section

37 See Commission Proposal, recital 20. ^ Back to section

38 See Directive, article 3(1)(f). ^ Back to section

39 Directive, recital 26. Consumer waste disposal and products subject to export controls are also excluded, see Directive, article 3(1)(g)(ii). ^ Back to section

40 Regulated financial undertakings are nonetheless expected to consider adverse impacts and to use their leverage to influence business relationships. See Directive, recital 51. ^ Back to section

41 See Directive, recital 98. ^ Back to section

42 See Directive, recital 32 and Annex I, Part I, section 1. ^ Back to section

43 See Annex, Part I, section 2. ^ Back to section

44 See Annex, Part II. ^ Back to section

45 See Commission Proposal, page 2 (noting that EU companies regrettably have been associated with adverse human rights and environmental impacts, such as forced or child labour, inadequate workplace health and safety, exploitation of workers, greenhouse gas emissions, pollution, biodiversity loss or ecosystem degradation). ^ Back to section

46 Directive, recital 41. ^ Back to section

47 Directive, articles 10(2)(d) and 11(3)(e). ^ Back to section

48 Directive, articles 10(3) and 11(4). ^ Back to section

49 See Directive, recitals 45 and 53. ^ Back to section

50 Directive, articles 10 and 11. ^ Back to section

51 Directive, articles 10(5) and 11(6). ^ Back to section

52 See Directive, recitals 46 and 54. ^ Back to section

53 See, for example, the model contract clauses of the American Bar Association (based on US law and the United Nations Convention on Contracts for the International Sale of Goods); see also the Chancery Lane Project (with clauses designed for multiple jurisdictions). ^ Back to section

54 The Commission will likely provide guidance on model contract clauses, in consultation with member states and stakeholders. See Directive, recital 66. ^ Back to section

55 Directive, articles 10(5), paragraph 2 and 11(6), paragraph 2; see also recital 69. ^ Back to section

56 Directive, articles 10(2)(e) and 11(3)(f); see also recitals 46 and 54. ^ Back to section

57 Directive, articles 10(2)(b) and 11(3)(c); see also recitals 46 and 54. ^ Back to section

58 Directive, articles 10(4) and 11(5). ^ Back to section

59 Directive, recitals 46 and 54. ^ Back to section

60 Directive, article 9; see also recitals 54 and 80. ^ Back to section

61 See Directive, recitals 19, 45, 53 and 57. ^ Back to section

62 Directive, articles 10(2)(f) and 11(3)(g). ^ Back to section

63 Directive, recital 57. ^ Back to section

64 Member states shall ensure a right to suspend or terminate contracts governed by their laws where the implementation of a corrective plan to end a severe actual impact has failed and there is no reasonable prospect that working with the business partner causing the impact will remedy the situation. See Directive, articles 10(6) and 11(7); see also recital 57. ^ Back to section

65 Directive, articles 10(6) and 11(7). ^ Back to section

66 Directive, articles 10(6) and 11(7). ^ Back to section

67 Directive, articles 10(6) and 11(7). ^ Back to section

68 Directive, articles 10(6) and 11(7). ^ Back to section

69 Directive, articles 10(6) and 11(7)). ^ Back to section

70 Jonathan Barnett, 'The Answer My Friend… Is Blowing In The Wind: ESG in EU-Related Supply Chains', Kluwer Arbitration Blog, 21 March 2023, available at https://arbitrationblog.kluwerarbitration.com/2023/03/21/the-answer-my-friend-is-blowing-in-the-wind-esg-in-eu-related-supply-chains/. ^ Back to section

71 Ibid. ^ Back to section

72 See International Bar Association, 'Report on Use of ESG Contractual Obligations and Related Disputes, ESG Subcommittee of the IBA Arbitration Committee', 2023, page 33 (reporting, based on survey results, that confidentiality, transparency and the ability to select decision makers are the top three priorities for companies involved in business-to-business ESG dispute resolution). ^ Back to section

73 Ibid., pages 33–34 (suggesting, based on survey results, that reputational costs are given more weight than financial costs for respondents in ESG disputes, and that confidentiality remains important for companies seeking to resolve such disputes). ^ Back to section

74 Article 11(1)(c) of the Hague Rules. ^ Back to section

75 See Jonathan Barnett, 'The Answer My Friend… Is Blowing In The Wind: ESG in EU-Related Supply Chains', Kluwer Arbitration Blog, 21 March 2023 (cited above in footnote 72). ^ Back to section

76 Cf. Commission Proposal, page 2 (noting that voluntary standards have not adequately reduced the negative impacts of EU production and consumption, due to the lack of clarity on the extent of the corporate due diligence obligation, the complexity of value chains, market pressure, information deficiencies and costs). ^ Back to section

77 See Commission Proposal, pages 3 and 11. ^ Back to section

78 The Directive is proposed under the EU competence to coordinate safeguards required of companies to make these equivalent throughout the EU pursuant to articles 50(1) and 50(2)(g) of the Treaty on the Functioning of the European Union (TFEU). It also relies on article 114 TFEU, which allows the EU to adopt measures for the approximation of legal provisions, regulations or administrative action in member states that have as their object the establishment and functioning of the internal market. However, the Directive also refers to article 191 TFEU on EU policy on the environment. ^ Back to section

Westerberg

Maria Fogdestam Agius maria.fogdestam.agius@westerberg.com

Regeringsgatan 66, PO Box 3101, 103 62 Stockholm, Sweden

Tel: +46 8 5784 03 00

https://westerberg.com