

The EU Supply Chain Directive

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Vienna, 09.03.2022

I. Content

New Obligations and Liabilities

New obligations:

- The Directive lays down obligations to conduct due diligence, monitor and remediate **human rights adverse impacts** and **environmental adverse impacts**, with respect to (1) the company's **own operations**, (2) the operations of the company's subsidiaries and (3) (very far reaching) the **value chain operations** carried out by **entities with whom the company has an established business relationship**.

New sanctions and liabilities:

- Directive provides for liability for violations of the above-mentioned duties.

Relationship to national laws and EU legislation

- Various **national rules** on supply chains already exist
 - France: „Loi de vigilance“ introduced in 2017;
 - Germany: „Lieferkettengesetz“ will apply from 2023 to groups with more than 3,000 employees in Germany. In a second step, starting in 2024, it will also apply to companies with more than 1,000 employees, which would mean that almost 2,900 companies would be affected.

So far, companies have **not been subject to civil liability**.

- Compared to existing Member State laws, the stricter rules prevail.
- In case of conflict with other Union legislative acts that pursue the same objectives and provide for more extensive or more specific obligations, the provisions of the other Union legislative acts prevail. – Again, the stricter / more specific rules prevail.

Thresholds – EU companies (1)

Thresholds - EU companies:

- Company must have been formed in accordance with the legislation of an EU Member State; **and**
- Have more than **500 employees on average** and **net worldwide turnover of more than EUR 150 million in the last financial year for which financial statements have been prepared**; or
- Have more than **250 employees on average** and net worldwide **turnover of more than EUR 40 million in the last financial year for which financial statements have been prepared**, provided that at least 50% of this net turnover was generated in one or more **risk sectors**.

Specifics:

- Part-time employees count on a full-time equivalent basis. Temporary agency workers shall be included in the calculation in the same way as directly employed workers.

Thresholds – EU companies (2)

- Sectors considered risk sectors:
 - **Manufacture of textiles, leather and related products** (including footwear), and the **wholesale trade** of textiles, clothing and footwear;
 - **Agriculture, forestry, fisheries** (including aquaculture), the manufacture of **food products**, and the wholesale trade of agricultural raw materials, live animals, wood, food, and beverages;
 - **Extraction of mineral resources** regardless from where they are extracted (including crude petroleum, natural gas, coal, lignite, metals and metal ores, as well as all other, non-metallic minerals and quarry products);
 - **Manufacture of basic metal products, other non-metallic mineral products and fabricated metal products** (except machinery and equipment), and
 - **Wholesale trade** of mineral resources, basic and intermediate mineral products (including metals and metal ores, construction materials, fuels, chemicals and other intermediate products).

Thresholds – Non-EU companies

Thresholds – Non-EU companies:

- Company has been formed in accordance with the legislation of a third country; **and**
- Generated a **net turnover of more than EUR 150 million in the EU in the financial year preceeding the last financial year; or**
- Generated **net turnover of more than EUR 40 million but not more than EUR 150 million in the EU in the financial year preceeding the last financial year** provided that **at least 50%** of its net worldwide turnover was **generated in a risk sector.**

Definitions (1)

Adverse environmental impacts: Adverse impact on the environment resulting from the violation of one of the prohibitions and obligations pursuant to the international environmental conventions listed in the Annex Part II.

Adverse human rights impacts: Adverse impact on protected persons resulting from the violation of the rights or prohibitions listed in the Annex, Part I Section 1, as enshrined in the international conventions listed in the Annex, Part I Section 2.

Business relationship: Relationship with a contractor, subcontractor or any other legal entities

- (i) With whom the company has a commercial agreement or to whom the company provides financing, insurance or reinsurance, or
- (ii) That performs business operations related to the products or services of the company for or on behalf of the company.

Established business relationship: Business relationship that is or is expected to be lasting, in view of its intensity or duration and which does not represent a negligible or merely ancilliary part of the value chain.

Definitions (2)

Value chain: Activities related to the production of goods or the provision of services by a company, including the development of the product or the service and the use and disposal of the product as well as the related activities of upstream and downstream established business relationships of the company.

Severe adverse impact: adverse environmental impact or adverse human rights impact that is especially significant by its nature, or affects a large number of persons or a large area of the environment, or which is irreversible, or is particularly difficult to remedy as a result of the measures necessary to restore the situation prevailing prior to the impact.

Corporate Due Diligence Duties (1)

- **Integration of due diligence into company policy:** Companies must establish a corporate due diligence policy. This policy must contain
 - **Description of due diligence approach** (including in the long term);
 - **Code of conduct** describing rules and principles to be followed by the company's employees and subsidiaries;
 - **Description of process in place to implement due diligence**, including measure taken to verify compliance with code of conduct and to extend its application to established business relationships.
 - **Annual updates** of due diligence policy.

Corporate Due Diligence Duties (2)

- **Identification of actual / potential adverse impacts:**
 - **Taking of appropriate measures to identify actual / potential adverse human rights impacts and adverse environmental impacts** arising (1) from their own operations and those of their subsidiaries and, (2) where related to their value chains, from their established business relationships.
 - **Reduced obligations for companies that only meet the secondary thresholds:** These companies do not have to conduct a full-fledged due diligence. They only have to identify actual or potential severe adverse impacts relevant to the respective “risk sector” in which they are active.

Corporate Due Diligence Duties (3)

- Companies shall be enabled by national legislation to **use information gathered through the complaints procedure** for their due diligence.
- Company's obligations extend to, where relevant, **consultations with potentially affected groups**, including workers and other relevant stakeholders to gather information on actual or potential adverse impacts.

Corporate Due Diligence Duties (4)

- **Prevention / mitigation of potential adverse impacts; termination / minimisation of identified adverse impacts:**
 - Taking of appropriate measures to prevent or at least adequately mitigate potential adverse human rights impacts and adverse environmental impacts that have been or should have been identified.
 - **Required actions:**
 - **Where necessary due to the nature or complexity of the measures required for prevention:** Development and implementation of a prevention action plan with reasonable clearly defined timelines for action and qualitative and quantitative indicators for measuring improvements.

Corporate Due Diligence Duties (5)

- Development of the preventive action plan in consultation with affected stakeholders.
- **Companies must seek contractual assurances from direct business partners** that these will ensure compliance with the company's code of conduct and, as necessary, the prevention action plan.
 - **Contractual cascading:** Requiring a contractual obligation of direct business partners to seek corresponding contractual assurances from their business partners if these business partners' activities are part of the company's value chain.
- **Appropriate measures to verify compliance:** Contractual assurances / contract shall be accompanied by appropriate measures to verify compliance. The company may refer to suitable industry initiatives or independent third-party verification.

Corporate Due Diligence Duties (6)

- **Necessary investments** into management, production processes and infrastructure to comply with the prevention action plan.
- **Provision of targeted and proportionate support for SMEs** with which the company has established business relationships, where compliance with the code of conduct or the prevention plan would jeopardise the viability of the SME.
 - Contractual assurances obtained from / contracts with **SMEs** need to be fair, reasonable and non-discriminatory.
Company shall bear the costs of independent third-party verification.
- **Collaboration within the limits of competition law with other entities** including, where relevant, to enable the company to bring the adverse impact to an end, particularly if no other action is suitable or effective.

Corporate Due Diligence Duties (7)

Limits to business relationships: Where potential adverse impacts could not be prevented or adequately mitigated by the measures above, the company shall be required to refrain from entering into new or extending existing relations with the partner in connection with or in the value chain of which the impact has arisen and shall, within their legal possibilities, take the following actions:

- **Temporary suspension of commercial relations**, while pursuing prevention and minimisation efforts; if there is a reasonable expectation that these efforts will succeed in the short-term;
- **Termination of the business relationship** with respect to the activities concerned if the potential adverse impact is severe.
- Member States shall provide for legal options to terminate such business relationships in contracts governed by their laws.

Corporate Due Diligence Duties (8)

- **Ending adverse impacts:**
 - Companies shall be required to take the following **actions**, where relevant:
 - **Neutralisation / minimization of adverse impacts**, including payment of damages to affected persons and financial compensation of affected communities. Action shall be proportionate to the significance and scale of the adverse impact and to the contribution of the company's conduct to the adverse impact.
 - Where necessary because the adverse impact cannot be immediately ended, **development and implementation of a corrective action plan** with reasonable and clearly defined timelines for action and qualitative and quantitative indicators for the measurement of improvements. Where necessary, the corrective action plan shall be developed in consultation with stakeholders.

Corporate Due Diligence Duties (9)

- **Seeking of contractual assurances** from direct partners with established business relationships with the company that they will ensure compliance with the code of conduct and, as necessary, the company's corrective action plan, including through contractual cascading.
- **Making of necessary investments**, such as into management, production processes, infrastructures.
- **Provision of targeted and proportionate support for SMEs** with which the company has an established business relationship where compliance with company's code of conduct or corrective action plan would jeopardise the viability of the SME.
- In compliance with EU law including competition law, **collaboration with other entities** also to increase the company's ability to end the adverse impact, in particular where no other action is suitable or effective.

Corporate Due Diligence Duties (10)

- Contractual measures must be accompanied by **appropriate measures to verify compliance**. Possibility to refer to suitable industry initiatives and independent third-party verification.
- **Terms used in contractual assurances and contracts with SMEs must be fair, reasonable and non-discriminatory.**
Company must bear the cost of independent third-party verification in relationship with SME.

Corporate Due Diligence Duties (11)

- Where adverse impacts could not be ended or minimized the company shall **refrain from entering into new or extending existing relations** with the partner in connection to or in the value chain of which the impact has arisen and shall take one of the following actions:
 - **Temporary suspension** of commercial relationships while pursuing efforts to bring to an end or minimize the extent of the adverse impact; or
 - **Termination of the business relationship** regarding the activities concerned, if the adverse impact is considered severe.
- Member States shall ensure that companies have a legal option to terminate the business relationship in such situations in contracts governed by their national laws.

Corporate Due Diligence Duties (12)

- **Climate change duties:**
 - **Large (threshold 1) companies** shall adopt plans to ensure that their business models and strategies are compatible with the transition to a sustainable economy and with limiting global warming to 1.5 degrees in line with Paris Agreement. Plan shall identify, on the basis of reasonably available information, to what extent climate change is a risk for, or an impact of, the company's operations.
 - Where climate change is or should have been identified as a principal risk for or impact of the company's operations, the company must include emissions reductions objectives into its plan.

Corporate Due Diligence Duties (13)

- **Variable remunerations** linked to the contribution of a director to the company's business strategy and long term-interests and sustainability must take into account the fulfillment of the above-mentioned climate change duties.

Corporate Due Diligence Duties (14)

- **Competition law exemption?** Member States shall ensure that companies are able to share information also with other legal entities in compliance with applicable competition laws.

Other Duties (1)

- **Assignment of authorized representative** of the company entitled to receive communication from and cooperate with the relevant Member State supervisory authorities.

Complaints procedure (1)

- **Provision of complaints procedure for persons and organisations** for legitimate concerns regarding actual or potential adverse human rights impacts and adverse environmental impacts with respect to their own operations, the operations of their subsidiaries and their value chains.
- Complaints procedure must enable complaints (i) **by persons affected** by the adverse impact, (2) **trade unions and workers' representatives** representing individuals working in the relevant value chain and (3) **civil society organisations** active in the areas related to the value chain concerned.

Complaints procedure (2)

- **Establishment of procedures to deal with complaints** and information of relevant workers and trade unions of the procedures. Companies must **take actions to end / mitigate the impact of identified adverse impacts.**
- **Complainants shall be entitled to request follow-ups** on the complaint and to **meet with the company's representatives** at an appropriate level to discuss potential or actual severe adverse impacts that are the subject matter to the complaint.

Monitoring

- **Periodic assessments** of own operations and measures, those of subsidiaries and those of established business relationships in their value chains based on qualitative and quantitative indicators and carried out at least every 12 months and whenever there are reasonable grounds to believe that there are significant new risks that could create adverse impacts.
- Due diligence policy has to be updated based on the outcome of the assessment.

Reporting requirements

- Companies that are not anyway subject to reporting requirements under Art. 19a, 29a of Directive 2013/34/EU have to report on their supply chains by publishing on their website an **annual statement** in a language customary in the sphere of international business. Statement has to be published by 30 April each year covering the previous calendar year.
- Criteria will be defined in delegated acts of the EU Commission.

Sanctions

- Size of administrative fines will be set by Member State legislation.
Sanctions will have to be effective, proportionate and dissuasive and shall take the (group) turnover of the company into account.
- Sanctions shall take into account company's efforts to comply with remedial actions required by the supervising authority, investments made and targeted support provided by the company as collaboration of the company with other entities to address adverse impacts in the value chain.
- Decisions containing sanctions will be published.

Civil liabilities (1)

- Member States shall ensure that companies are **liable for damages** if they fail to comply with their obligation to prevent and end / mitigate adverse impacts and the adverse impact results in damages.
- Liability **shall take into account the company's efforts**, if related directly to the damage in question, to comply with remedial action required by the relevant supervisory authority, investments made and any targeted support provided to fulfil obligations to prevent and end / mitigate adverse impacts, as well as any collaboration with other entities to address adverse impacts in the value chain.
- There may be **additional civil liability of subsidiaries and business partners** in the value chain.

Civil liabilities (2)

- Member States must ensure that the liability in national regulation transposing the directive is of overriding mandatory application in cases where the law applicable to the claims is not the law of a Member State.

Other consequences

- **Restrictions to public support:** Companies applying for public support must confirm that no sanctions have been imposed on them for failure to comply with the obligations of the Directive.
- **Breach of directors' duties of care:** Member State laws shall ensure that provisions providing for breach of director's duties apply also to the duty to take into account the consequences of decisions for sustainability matters, including (as applicable) human rights, climate change and environmental consequences in the short, medium and long term. Directors shall be responsible to put in place and oversee due diligence actions and due diligence policy and shall take steps to adapt the corporate strategy to take into account actual and potential adverse impacts that have been identified.

Supervisory authorities (1)

- Member States have to create / assign independent supervisory authorities.
- Supervisory authorities shall have the following **powers**:
 - Initiation of investigations;
 - Requests for information from companies;
 - Inspections on the premises of companies. Prior warning unless this would hinder the effectiveness of the inspection;
 - Order of the cessation of infringements, abstention from repetition, proportionate remedial action;
 - Imposition of administrative sanctions;
 - Adoption of interim measures to avoid severe and irreparable harm.

Supervisory authorities (2)

- Member States have to ensure that natural and legal persons can submit complaints to supervisory authorities.
- Supervisory Authority's decision whether to take action must be subject to review by a court or independent and impartial body regarding the procedural and substantive legality of the decision.

EU Guidance

- EU Commission will provide guidance through
 - Guidelines; and
 - Model contract clauses.

II. Next Steps



Legislative Procedure

- The proposal will be presented to the European Parliament and the Council for approval.
- Once adopted, Member States will have **two years** to transpose the Directive into national law and communicate the relevant texts to the Commission. The obligations for Threshold 2-companies enter into force **four years** after the adoption of the Directive.
- The EU Commission published a Communication on Decent Work on 23 February 2022. This affirms, among other things, that the EU promotes decent work in all sectors and policy areas as part of a comprehensive approach targeting workers in domestic markets, in third countries and in global supply chains.



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Practice Areas

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Thank you
for your attention