

April 14 2023

Corporate sustainability due diligence: supply chain actors should prepare for compliance control now

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Introduction

International supply chains have been subject to increased pressure and external change factors that have negatively influenced flow security, such as:

- the war in Ukraine;
- increased protectionism;
- the aftermath of covid-19 disruptions in global logistics;
- the aftermath of Brexit;
- climate change and socio-economic developments;
- political initiatives for self-sufficiency; and
- international sanctions on Russia.

Geopolitical developments have an ever-increasing impact on businesses. Thus, businesses are forced to play a key role in the execution of political issues. This is why international supply chain actors are advised to prepare for due diligence obligations that follow from these geopolitical developments, and that will become a part of their standard information package and reporting duties. This article focuses on upcoming sustainability, due diligence obligations for both EU and non-EU companies.

Compliance control preparation

Corporate sustainability due diligence will, however, remain a hot topic. This is because diligence is considered a major tool for identifying risks in the value chain and building resilience to sudden changes in that chain. Recent discussions – both political and in the media – have focused on the possible consequences for companies in the (extreme) event of non-compliance. However, the most important practical consequence for commercial interests in the international value chain – following from national and supranational legislation already enacted or soon to be enacted – is the administrative burden that will be put on businesses. This administrative burden will require that detailed and complete information on the entire international supply chain be identified, made available, and acted upon.

This administrative burden will likely require internationally operating businesses to dedicate substantial financial and personal resources to comply with due diligence obligations that will be imposed on them on short notice. Thus, businesses are advised to be aware of this and to start preparing. Recent examples based on national, corporate sustainability and due diligence legislation already in force have shown that commercial interests will need to have all the mandatory instruments in place and on time, so as to be able to act in compliance as soon as businesses and their directors are legally required to do so.

Various European supply chain due diligence rules are already in place (ie, regulations on conflict minerals and diamonds, and timber products) and others are about to enter into force (ie, regulations on carbon border adjustment mechanisms, forced labour and the re-use of waste batteries). These rules all require commercial interests to:

- know how the products they put on the European market were manufactured;
- record and publish evidence to demonstrate this knowledge; and
- to act in case of violation of the rules by the company or the parties in its supply chain.

Complementing these existing rules – and as part of the European Green Deal – the European Commission adopted a proposal for a comprehensive Corporate Sustainability Due Diligence Directive (CSDDD) in February 2022. The aim of the CSDDD is to foster sustainable and responsible corporate behaviour and to anchor human rights and environmental considerations in companies' operations and corporate governance. The new rules must ensure that internationally active businesses address adverse impacts of their actions, including in their value chains inside and outside Europe.

Interestingly, several European member states did not want to wait for the European legislative process to be completed, and have already introduced national legislation of their own. France and Germany have enacted national due diligence laws that are already being enforced. Other member states (ie, Belgium, Luxembourg, Sweden) are currently planning to do so in the near future and, as stated,

discussion of draft legislation before parliament in the Netherlands is currently on hold. German companies are already being requested to submit detailed information on their supply chain compliance to the regulatory control authorities.

The CSDDD is currently a commission proposal that will be put before the European parliament and council for approval. Once adopted, member states will have two years to transpose the directive into national law.

The CSDDD establishes corporate due diligence duty that is designed to respect human rights and the environment in a company's own operations and through its value chains, by:

- identifying, preventing, mitigating and accounting for adverse human rights and environmental impacts; and
- having adequate governance, management systems and measures in place.

The core elements of this overall duty require companies to integrate due diligence into corporate policies, assess and prevent adverse human rights and environmental impacts on their business, and publicly communicate due diligence policies and measures taken.

More specifically, the SCDDD requires all European member states to ensure, via national legislation, the following:

- Companies must have corporate policies that include descriptions of:
 - the company's approach to due diligence;
 - a code of conduct to be followed by the company's employees and subsidiaries; and
 - the processes put in place to implement due diligence.
- Companies must take appropriate measures to identify, prevent and mitigate actual or potential adverse human rights and environmental impacts in:
 - their own operations;
 - in their subsidiaries; and
 - at the level of their established direct or indirect business relationships in their value chain.
- Companies must provide for the ability to submit complaints to the company about legitimate concerns regarding any adverse impacts, including in the company's value chain. This ability should be open to:
 - persons who are affected by any adverse impact;
 - trade unions; and
 - civil society organisations.
- Companies must periodically assess the implementation of their due diligence measures.
- Companies must periodically report on all matters covered by the SCDDD and publish an annual statement on their website.

These obligations not only concern the company's own operations, but also its subsidiaries and value chains (direct and indirect established business relationships).

The new due diligence rules will apply to both EU and non-EU companies.

EU companies

These rules apply to all EU limited liability companies of substantial size and economic power (ie, companies with more than 500 employees and over €150 million in net turnover worldwide).

They also apply to other limited liability companies operating in defined high impact sectors (ie, clothing, agriculture, food and beverage products, oil, gas and metals), which do not meet the thresholds mentioned above, but have more than 250 employees and a net turnover of €40 million worldwide.

Non-EU companies

The due diligence rules apply to companies active in the European Union with turnover thresholds aligned with the companies above, having generated all this turnover in the European Union.

As an additional obligation, companies formed in accordance with the legislation of a third country and falling within the scope of application of the SCDDD are to designate an authorised representative in the European Union to be addressed by the competent authorities, on all issues necessary for the receipt of, compliance with and enforcement of legal acts issued in relation to the SCDDD.

Small and medium enterprises (SMEs) are not directly in the scope of the current proposal. Certain large companies, however, are additionally obliged to make and implement plans to ensure that their business strategy is compatible with limiting global warming to 1.5° Celsius as per the Paris Climate Change Agreement.

Mitigating risks in value chains

Various legislative proposals make it clear that internationally active trading businesses, as well as all operators in their supply chain, are being identified as playing a major role in creating a sustainable and fair economy and society. Thus, they will be confronted with increased human rights and environmental compliance scrutiny. The increasing complexity and global nature of supply chains, however, makes it challenging for businesses to identify and mitigate risks in their value chains linked to respect of human rights or environmental impacts. The idea is that identifying these adverse impacts in value chains will become easier if more companies exercise due diligence. More data will be available on human rights and environmental adverse impacts, enabling companies to obtain, assess, publish and act upon reliable information on the operations of all their suppliers, customers and logistics partners.

Enforcing due diligence rules

The CSDDD introduces duties not only for the company, but also for its directors. These duties include setting up, overseeing and reporting on the implementation of due diligence processes, and integrating due diligence into the corporate strategy, while considering relevant input from stakeholders and civil society organisations. In addition, when fulfilling their duty to act in the best interest of the company, directors must consider the human rights, climate change and environmental consequences of their decisions.

The rules on corporate sustainability due diligence will be enforced by two things.

Administrative supervision

Member states must designate an authority to both supervise and impose sanctions upon non-compliance, including fines and compliance orders. At the European level, the commission will set up a European Network of Supervisory Authorities that will bring together representatives of the national bodies to ensure coordination and alignment of regulatory, investigative, sanctioning and supervisory practices.

Civil liability

Member states must ensure that victims get compensation for damages resulting from failure to comply with the obligations laid down in the CSDDD.

The SCDDD explicitly provides for the possibility for any natural or legal person that has reasons to believe that a company does not appropriately comply with its due diligence obligations, to submit to the supervisory authorities. Persons reporting breaches of the SDCCC fall under the scope of the EU Whistleblowing Directive.

Comment

The future holds serious administrative burdens for parties in the international value chain. The major takeaway – even though national due diligence legislation is fragmented, and supranational legislation is still in the making – is that companies and their directors should ideally start preparing now lest they be confronted with immediate substantial policy and reporting obligations once the legislation kicks in. Complying with these obligations will not only take time, but also ample financial and human resources. In view of the volatility of the markets, challenging economic outlooks and shortage of skilled personnel, proactive implementation of supply chain compliance should be made part of company policy now.

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