Commentary to the

Zero Draft for Consultation:

The European Model Clauses (EMCs) for Responsible and Sustainable Supply Chains

July 2024

Prepared by the European Working Group for Responsible and Sustainable Supply Chains.

Article 1

I. General Commentary to Article 1

1. Introduction

The Article (as well as the other Articles of these model clauses) is built on the presumption that buyers move from representations and warranties to human rights and environmental due diligence. The reason for this is that two reasons exist to enhance operational effectiveness and enforced legal requirements. For many MNEs there is not much of a risk calculus on this score; simply put, human rights and environmental due diligence is currently required in some European countries (France and Germany) and may be required by EU law. Even for MNEs that are not subject to these laws, and for SMEs in similar circumstances, the move still makes sense. Indeed, upon the respect of the specific thresholds established by the Corporate Sustainability Due Diligence Directive (EU 2024/1760, CSDDD), complying with HREDD duties will be mandatory not only for companies formed in accordance with the law of European countries, but also of non-European countries, when they generate a certain amount of turnover in the EU. The extended scope of application of the Directive makes the requirement to comply with human rights and environmental due diligence very far reaching and the resort to European Model Clauses recommended in a very huge variety of cases. Moreover, Article 29(7) of the CSDDD provides for the overriding mandatory application of the EU Members States' domestic rules introduced in conformity with the Directive and governing the corporate liability for human rights and environmental abuse or damages - with the reasonable implications on contractual issues - even in cases where the law applicable to these claims is the law of a third State pursuant to the relevant private international law rules. Again, this latter provision contributes to expanding the need for companies to conform to the human rights and environmental due diligence duties and following the EMCs within their contracts.

It should be noted that the regime of representations and warranties, with their accompanying liability—if they are not true, there is breach—is unrealistic and ineffective. Frequently, this regime is thought to lead to what is called a "tickbox" or "checkbox" approach to supply chain management in which buyers require a laundry list of representations of compliance from their suppliers. Suppliers mechanistically provide them by checking the boxes (although they may be more than a little resentful of time wasted filling forms).

The participants in the supply chain are no longer being asked, unrealistically and fictitiously, to literally guarantee that no Adverse Impact will occur as well as perfect compliance with the responsible purchasing practices in Article 1.3(a). Instead, they are being required to undertake due diligence, on an ongoing basis, about achieving those goals. This is not mere aspiration; the parties are contractually obligated to use reasonable means to achieve these goals.

Although the language regarding corporate sustainability due diligence included in the OECD Guidelines or UNGPs is not well suited for contract clauses, the following list provides a good, though not exhaustive, understanding of the concept, which is also aligned with the CSDDD. Human rights due diligence includes:

(i) embedding responsible business conduct into the culture of the company through leadership, incentives, policies, and management systems;
(ii) identifying and assessing actual and potential adverse human rights impacts, throughout the supply chain, that the contract-related activities may cause or contribute to, or that may be directly linked to the operations, products, or services contemplated by the contract;
(iii) ceasing, preventing, and mitigating such adverse impacts;
(iv) tracking and monitoring, in consultation and collaboration with internal and external stakeholders, the success of mitigation or prevention;
(v) communicating how adverse impacts are addressed, mitigated or avoided; and
(vi) providing for or cooperating in remediation where appropriate.

Effective due diligence requires looking at risks through the perspective of the stakeholder, as learned through engagement with the stakeholder; the prioritization of responsive action by severity of impact on the stakeholder; the need to search on an ongoing basis for human rights risks throughout the entire supply chain, and not just the first few tiers; the development of leverage to influence contractual parties to refrain from, mitigate, or remediate harm to human rights; and the need to go beyond the limits of local law. In other words, human rights due diligence is a necessary part of ongoing supply chain management; it is proactive, forward and backward looking, responsive to actual or potential impacts, and requires meaningful and regular engagement with stakeholders.

It should be noted, as Recital 66 of the CSDDD states, that contractual assurances cannot, on its own, satisfy the due diligence standards provided for in the CSDDD. That said, they are an important means of transposing HREDD obligations throughout the supply chain, as has been elaborated in the introduction.

2. Section 1.1

(a) This provision is written to ensure compliance with Human Rights and Environmental Due Diligence as required by the CSDDD. One should bear in mind that this is not the only relevant instrument in the Business Human Rights field. One may also think of relevant UN Human Rights and ILO conventions. Many of them are mentioned in Article 18 of the EU Green Taxanomy[1] and Annexes I and II to the CSDDD. Article 1.1 (a) also refers to other relevant European regulation. One may next to the CSDDD think of the Deforestation Regulation (EU 2023/1115), Articles 48-52 of the Batteries

[1] Regulation EU 2020/852.

Regulation (EU 2023/1542) and the Conflict Minerals Regulation (EU 821/2017). Furthermore, it is relevant to see to it that due diligence is commensurate with the draft regulation Com(2022) 453 final on prohibiting products made with forced labour on the Union market.

In case the provisions in these model clauses or the CSDDD itself are not sufficiently clear, they may be interpreted using the 2011 United Nations Guiding Principles on Business and Human Rights and with guidance from the Organisation for Economic Cooperation and Development for the applicable party's sector or, if no such sector-specific guidance exists: shall be consistent with the 2018 OECD Due Diligence Guidance for Responsible Business Conduct (the OECD Due Diligence Guidance.

This collaboration to establish and undertake environmental and human rights due diligence is at the core of this agreement. It is also at the core of the CSDDD. For example, Recitals 46, 54 and 66 note that contractual assurances should be designed to ensure that responsibilities are shared appropriately by the company and the business partners. According to Recital 46 this may include making financial or non-financial investments. Therefore, it should be part of the core of the Agreement and not be contemplated for in general terms and conditions or suppliers' codes of conduct. Collaboration may include providing training to and capacity building with suppliers, also down the supply chain, as well as cost sharing regarding required measures to undertake Human Rights and Environmental Due Dilligence, as implemented in a remediation plan or remediation. Furthermore, Buyer must realize that they may have to assess the capacity of the supplier in order to assess whether it has the capacity to undertake Human Rights and Environmental Due Diligence.
In case the provisions in these model clauses or the CSDDD itself are not sufficiently clear, they may be interpreted using the 2011 United Nations Guiding Principles on Business and Human Rights and with guidance from the Organisation for Economic Cooperation and Development for the applicable party's sector or, if no such sector-specific guidance exists: shall be consistent with the 2018 OECD Due Diligence Guidance for Responsible Business Conduct (the OECD Due Diligence Guidance).

(b) The CSDDD (Article 13), as well as other instruments, such as the OECD Guidelines, put stakeholder engagement at the core of the due diligence process.[2] After all this process is designed to prevent and mitigate Adverse Impacts to these stakeholders (rights holders). Therefore, this section implements the obligation of parties in this respect in this agreement. It includes a responsibility:

(i) To identify their Adverse Impacts accurately, Buyer and Supplier shall seek to understand the concerns of Stakeholders by consulting them directly in a manner that takes into account language and other potential barriers to effective engagement. Where such consultation is not possible, the parties shall consider reasonable alternatives such as consulting credible, independent expert resources, including human rights defenders and others from civil society.

(ii) As part of the consultation process, Buyer and Supplier shall take steps to provide Stakeholders with pertinent information regarding their human rights and environmental position, and other relevant information necessary for Stakeholders to meaningfully engage in the parties' Human Rights and Environmental Due

[2] See the OECD Guidelines, II.15 and Recitals 40 and 65 CSDDD.

Diligence process.

(iii) Where Stakeholders reasonably request additional information from Buyer and Supplier, each party shall, within a reasonable time frame, either provide such information or submit a written justification for not doing so.
The parties shall determine which Stakeholders to engage and the intensity of the engagement based on the degree of the Adverse Impact on such Stakeholders.

In this engagement experts may be an additional source of information. In case engagement with stakeholders or the legitimate representatives is not feasible, Buyer or Supplier may rely on credible proxies. However, this should be a last resort option.

(c) This section is connected to Article 10 2(a) CSDDD, which requires the development and implementation of such a plan to prevent potential adverse impacts.

(d) The section, obviously, presumes all of the information provided in relation will be accurate (provided in a digital format), and enabling the receiving party to comply with the CSRD and the ESRS and any other applicable reporting obligations, to conduct risk analyses and to adapt the due diligence process if required. This Article governs information regarding the (implementation of) the Human Rights and Environmental Due Diligence process. The higher the risk connected with a supplier is, the more frequent information should be provided. Information regarding Adverse Impacts should also be communicated. It should be noted that the CSRD and ESRS also require communication of actual impact.

Suppliers are often reluctant to provide such information as they fear measures of Buyer, such as termination, no further assignments and damage claims. Therefore, it may be helpful to discuss with Supplier how and for which purposes this information will be used and which effect the information may generate. It is also good to emphasize that collaboration can only be meaningfully implemented if both parties act in good faith and are willing to share information.

Buyer may also annually and ad hoc request information in relation to potential and actual adverse impacts by way of a questionnaire. The questionnaire must be based on the Buyer's findings from their risk analysis. Such questionnaires shall be reasonable in scope and, whenever possible, designed to reduce the administrative burden for the responding party and to be consistent with the questionnaires developed by relevant industry associations or used by other companies operating in the same industry and in the same capacity as Buyer and or Supplier. Buyer may consider recognizing questionnaires completed on behalf of other buyers in order to save the supplier time, cost and effort. Many Suppliers have multiple Buyers. Oftentimes these Buyers have implemented their own Human Rights and Environmental Due Diligence process including questionnaires, audits and scorecards. If the Supplier has to fill in all these questionnaires and has to accept multiple audits (for which it usually also has to pay), this is a heavy burden. This section aims to alleviate this burden by implementing recognition of (comparable) questionnaires or audits for other Buyers. An equivalent document as referred to in this section is, for example, a questionnaires completed for another buyer or an audit reports prepared by a reputable third-party. Recital 56 of the CSDDD also refers to this option in connection with SMEs.

Large European enterprises have specific obligations to report on their social performance as of 1 January 2023 (and pursuant to article 19a broadened to small and medium sized listed and other

larger enterprises as of 1 January 2026).[3] Enhanced specificity of reporting requirements as set forth by Article 19a section 2 (f), for example, includes a description of the human rights due diligence process, of actual or potential adverse impacts identified and any action taken to prevent, mitigate or remediate any actual or potential adverse impacts as well as pursuant to article 19a section 2 (g) a description of the principal risks. This is further elaborated in the delegated instrument European Sustainability Reporting Standards (ESRS). According to Considerations 45 and 49 sustainability reporting should include international standards, such as the UNGPs and should also disclose impact of undertakings on people in connection with which dialogue and exchange of views between workers' representatives and a company's management is required and their opinions should also be communicated to relevant administrative management and supervisory bodies pursuant to Recital 50. Recital 55 also requires that this information should be available in digital format. Furthermore, pursuant to Article 30(1) the information shall be published within 12 months after the balance sheet date. Thus, section 1.1(b) includes the obligation to provide and exchange such information. In some case Supplier may be governed by sustainability reporting obligations under domestic law implementing the CSRD and has published such a report. The relevant information may be in the report in such instance and the Supplier may then refer to this report.

However, the section does not allow Buyer to send unspecified 'one size fits all' information requests down the supply chain. The Buyer should only ask for specific information, explain why this information is needed, and should consider the risk of Adverse Impact with this specific Supplier as well as the ability of the Supplier to comply with the request, especially if Supplier is an SME.[4] Furthermore, Suppliers may be reluctant to provide information on their sub-suppliers because they fear to be bypassed by the Buyer.[5] Therefore, it needs to be clarified to them why the information is needed and to discuss with them these justified fears and collaborate to find a solution for this issue.

Thus, the information request should be tailored to the situation of a Supplier. For example, a Supplier may provide information regarding audits of its sub-supplier without mentioning its name or using an intermediary software tool (which does not provide the name to Buyer).[6] Alternatively, Buyer may provide tools and financial resources to Supplier to conduct its own assessment of its supply chain.[7]

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[3] See COM (2021)189 final, accessible at https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:52021PC0189&from=EN, amending Directive 2014/95/EU, which can be accessed at https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32014L0095&from=EN. However, article 19c of the draft Directive allows for less specific reporting requirement for small and medium sized enterprises.

[4] Cf. BAFA Guidance ("Zusammenarbeit in der Lieferkette zwischen verpflichteten Unternehmen und ihren Zulieferern - Die wichtigsten Fragen und Antworten für KMU", 1ed June 2023), p. 2, 3, 8, 18 and 19, Accessible at here: https://www.bafa.de/SharedDocs/Downloads/EN/Supply_Chain_Act/guidance_cooperation_supply_chain.html?nn=1469788.

[5] BAFA Guidance ("Zusammenarbeit in der Lieferkette zwischen verpflichteten Unternehmen und ihren Zulieferern - Die wichtigsten Fragen und Antworten für KMU", 1ed June 2023), p. 20.

[6] See BAFA Guidance ("Zusammenarbeit in der Lieferkette zwischen verpflichteten Unternehmen und ihren Zulieferern - Die wichtigsten Fragen und Antworten für KMU", 1ed June 2023), p. 21 and 22.

[7] See BAFA Guidance ("Zusammenarbeit in der Lieferkette zwischen verpflichteten Unternehmen und ihren Zulieferern - Die wichtigsten Fragen und Antworten für KMU", 1ed June 2023), p. 21.

It is important to note that information provided by Supplier in the agricultural sector may pursuant to Article 3(1)(h) Unfair Trade Practices Directive in agricultural supply chains not lead to retaliation against this supplier, for example, by reducing or cancelling orders. One may consider to broaden this to other sectors as well.

(e) This section clarifies that the collaboration under Article 1.1 (a) does not imply that the parties are not independently responsible for upholding HREDD obligations.

(f) A HREDD contact point is a helpful tool in high-risk supply chains. Outside these high-risk supply chains it may be less needed.

3. Section 1.2

UN Guiding Principle 13, the 2023 OECD Guidelines for Responsible Business Conduct and the CSDDD require that businesses avoid causing or contributing to (environmental and) human rights harms through their own activities, address such impacts where they occur, and seek to prevent or mitigate adverse human rights and environmental impacts that are directly linked to their operations, products, or services by their business relationships through exercising leverage over these business relationships. Accordingly, this clause seeks to embed obligations to comply with human rights and environmental standards through the entire supply chain. However, this should, as has been elaborated in the introduction, not result in a shift of responsibility to the Supplier. As stated in Article 1.1 both Buyer and Supplier are responsible for the implementation of Human Rights and Environmental Due Diligence. Recital 54 of the CSDDD seems to allude to this as well, especially in connection with corrective action plans.

In keeping with the modular approach of these clauses, businesses may want to circumscribe their responsibility in line with the degree to which they are connected to the activities of the business. The current text implements a best effort obligation for the Supplier to implement the Human Right and Environmental Due Diligence Process of Buyer on its subcontractors or, if Supplier and/or subcontractors have implemented their own Human Rights or Environmental Due Diligence process consistent with the OECD Guidelines, rely on this process and communicate this to Buyer. In both situations (implementation of the process of Article 1.1 or OECD compliant due diligence) the Human Rights and Environmental Due Diligence process imposed on the subcontractor should be proportionate to its size and the circumstances. For example, a smallholder may have very limited due diligence responsibilities and may be a rights holder too.

This section also includes an obligation to document the contracts with subcontractors. It follows from Article 1.1 (d)(ii) that Supplier must deliver such records.

This responsibility of Supplier regarding subcontracting may be expanded beyond Article 1.2(b) by adding:

> When Supplier acts as a buyer or in a similar capacity in its contracts with sub-suppliers or subcontractors, Supplier shall ensure that it complies with all of the Buyer responsibilities stated in this Agreement. Such responsibilities include, without limitation, sharing responsibility for HREDD, engaging in responsible purchasing practices as implemented in Article 1.3, and engaging in responsible exit as laid out in Article 2(e).

Cascading environmental and human rights due diligence may be challenging or not required if the Supplier has his own code of conduct which is equivalent to that of the Buyer or the most appropriate one to use. The obligation to provide information about the Supplier's own value chain should not be limited to contractual information, but more general to due diligence approaches if an Adverse Impact occurs. All the responsibilities that Buyers assume in this contract, can be assumed by the Supplier in his contract with its suppliers. However, the concept of such obligations of means are clear to practitioners (in Europe), but it may be less clear how they should be achieved and what is exactly expected in practice. Therefore, translating these into the entire supply chain may be challenging and elaboration of the due diligence process further down the supply chain, including which supplier is responsible for which risk, may be helpful. For example, the focus may be on material suppliers and high risk. Furthermore, Suppliers may be reluctant to provide information on their sub-suppliers because they fear to be bypassed by the Buyer.[8] Therefore, it needs to be clarified to them why the information is needed and to discuss with them these justified fears and collaborate to find a solution for this issue.

One should note that the supply chain regarding a specific product may not be linear and may include a 'web' of supplier relationships. Cascading contractual clauses in such supplier webs is challenging, especially where sufficient leverage lacks. In such instances collaboration with business peers, as far as allowed by competition law and as envisaged by Article 10(2)(f) CSDDD, may be of assistance. Engagement in multistakeholder initiatives may be another option. This may render expectations of implementation of Human Rights and Environmental Due Diligence more common in supplier webs. In such supplier webs it is even more important to pay attention to the informational obligations included in section 1.1(d) to understand the shape of the web. Furthermore, Buyers should realize that they may be supplier as well. For example, if a Buyer sources fabrics from a supplier and sends these to another supplier for garment manufacturing, the Buyer is supplier to the latter and should undertake its own due diligence regarding the fabrics. The due diligence obligations as laid down in Article 1 become more reciprocal in such instances.

The section is commensurate with Articles 10(2)(b) and 11(3)(c) of the CSDDD as it requires companies to seek contractual assurances from the partners of their partner including appropriate measures to verify compliance. Recitals 49 and 50 of the CSDDD clarify that a company may also have to collaborate itself with indirect business partners to address impact further up the supply chain.

The recordkeeping as required by this section may be necessary to meet legislative reporting requirements as under the Corporate Sustainability Reporting Directive.

4. Section 1.3

(a) It is not uncommon for buyers to exert their leverage—such as threats of termination—to require discounts or other benefits from suppliers. Recitals 46 and 54 of the CSDDD also mention deadlines or specification imposed on the supplier. However, this type of behavior is contrary to the approach implemented in this model and also to the CSDDD as Recitals 46 and 54 explain. Recital 54 also clarifies that (irresponsible) purchasing practices may also result in buyer contribution to an impact.

[8] BAFA Guidance ("Zusammenarbeit in der Lieferkette zwischen verpflichteten Unternehmen und ihren Zulieferern - Die wichtigsten Fragen und Antworten für KMU", 1ed June 2023), p. 20.

Therefore, this provision is meant to allow supplier to enforce its rights despite any superior leverage that Buyer may have. Buyer is required to satisfy all obligations accrued prior to termination, including payment in full for goods produced without causing or contributing to Adverse Impact. Obviously, this section applies if a Buyer has leverage and is able to 'dictate' the conditions of the agreement. Whether this is the case depends on supply chain dynamics. Such leverage may lack in certain supply chains.

The EU directive on unfair trade practices in agricultural supply chains[9] defines in article 1 section 2 when an imbalance of power occurs between buyer and supplier using differences in turnover as an indicator. This may also be relevant in connection when determining if an SME is involved and how much leverage exists. Beyond this, the EU directive includes requirements which resemble the ones included in Article 1.3. Such unfair trade practices are not allowed in supply chain contracts.[10] Late payments and short-term termination of agreements regarding fungible goods are considered as such, although member states may allow an exemption if these goods can reasonably be sold elsewhere.[11] Beyond this and according to article 3 section 1 under c of the Directive more powerful buyers are not allowed to unilaterally change contractual terms, unless this regards a specific element, such as the agreed quantity, and this has been agreed upon.[12] Beyond this, Article 3(2) of the Unfair Trade Practices Directive in Agricultural Supply Chains, although it does not include explicit provisions on the burden of proof, imposes the burden of proof on the buyer if it desires to implement the provisions mentioned in this section. These provisions are prohibited unless the buyer proves these provisions meet the requirements for an exception to the general rule.

One should note that Recital 46 of the CSDDD refers to purchasing practices in the broader context of business plans, overall strategies and operations and not just in connection with supply chain contracts. Therefore, the obligations of Buyer (and Supplier if governed by the CSDDD) in connection with responsible purchasing practices may reach beyond implementing these in supply chain contracts.

Further guidance regarding responsible sourcing practices may be derived from Schedule Q to the ABA MCCs which provides good examples of responsible purchasing practices.[13]

(b) Articles 10(5) and 11(6) of the CSDDD require contractual assurances obtained from small and medium sized enterprises to be fair, reasonable and non-discriminatory. Recitals 46 and 54 of the CSDDD clarify that companies should provide targeted and proportionate support for a small and medium-sized enterprise (SME) which is a business partner of the company, where necessary in light of the resources, knowledge and constraints of the SME, including by providing or enabling access to capacity-building, training or upgrading management systems, and, where compliance with the code

[9] Directive EU 2019/633.

[10] This is especially relevant where an imbalance of power exits. The directive defines in Article 1(2) when an imbalance of power occurs between buyer and supplier through the use of differences in turnover as an indicator.

[11] Article 3 section 1 and Recitals 17 and 20 of the directive. However, late payment is allowed if model agreements of approved industry organisations (see Regulation EU 2013/1308) provide for this in connection with specific products. See article 3 section 1 under i) and consideration 19.

[12] See also Recital 21 of this directive.

[13] Which can be accessed at https://www.americanbar.org/content/dam/aba/administrative/human_rights/contractual-clauses-project/scheduleq.pdf.

of conduct or the prevention action plan would jeopardise the viability of the SME, providing targeted and proportionate financial support, such as direct financing, low-interest loans, guarantees of continued sourcing, or assistance in securing financing. The notion of 'jeopardising the viability of an SME' should be interpreted as possibly causing a bankruptcy of the SME or putting the SME in a situation where bankruptcy is imminent, pursuant to the Recital.

However, this is not limited to SMEs. Therefore, this obligation is broadened to suppliers more generally speaking. If responsible purchasing practices are implemented, but other parts of the agreement are not fair, not reasonable or discriminatory vis-à-vis larger suppliers, this may still hamper the implementation of Human Rights and Environmental Due Diligence.

This section requires Buyer to assist Supplier in implementing Human Rights and Environmental Due Diligence if necessary. Such assistance may include Supplier training, upgrading facilities, advice on measures to verify compliance and strengthening management systems. If an Adverse Impact has already occurred and even this assistance of Buyer is not sufficient to address an Adverse Impact, this triggers the obligation of Article 2.3 to design and implement a remediation plan.

Parties may consider deeming the cost of reasonable assistance to be a setup or mobilization expense associated with Supplier's preparing to provide goods to Buyer. For example, if Environmental or Human Rights due diligence effectively requires that Supplier make capital improvements to meet targets that may go beyond the minimum requirements of applicable law, Supplier's costs for such compliance may qualify for reasonable assistance from Buyer, especially is Supplier is an SME. Depending on the circumstances, Buyer and Supplier may determine that such assistance should be provided as a single payment at the beginning of the term of the Agreement or the parties may decide to spread assistance over time, over units delivered, or otherwise.

If SME suppliers are involved this support is required by Articles 7(2)(d) and 8(3)(e) of the CSDDD. Article 7(2)(d) in connection with Recital 34 of the CSDDD also requires financing, directly or through low-interest loans, as well as guarantees of continued sourcing and assistance in securing financing to assist an SME if its viability would be jeopardized. As the EMC implement the CSDDD requirements, this responsibility is limited to SMEs. However, reasonable implementation of Human Rights and Environmental Due Diligence may also require financial assistance with larger Suppliers. Therefore, one may consider broadening this provision to all Suppliers.

Where assistance is provided over time, the parties should clearly state when such assistance might be suspended or whether such assistance would be accelerated on early termination.

Articles 7 and 8 CSDDD also mention collaboration between Buyer and its business peers as a means to prevent or address actual Adverse Impacts. This section explicitly allows this.

It is important to note that a request of a Supplier in the agricultural sector pursuant to Article 3(1)(h) Unfair Trade Practices Directive in agricultural supply chains may not lead to retaliation against this supplier, for example, by reducing or cancelling orders. One may consider to broaden this to other sectors as well.

(c) This section requires in section (i) that the price paid to a supplier enables it to undertake due diligence and implement necessary measures to enhance the human rights and/or environmental situation. Recital 46 of the CSDDD explicitly refers to a living wage in this context. Often Buyer wants to ensure that the payment of the Living Wage is used solely for that purpose. Obviously, the Buyer

does not (only) want to increase the supplier management remuneration, but also desires to have the required measures implemented, for example payment of a living wage to workers or living income to smallholders. Therefore, it is not sufficient to just pay a higher price for the goods delivered. The Buyer may also contract for measures to safeguard and assess whether the additional funds paid are used to implement the required measures. External assurance may be a viable option to assess this. It may also ask Supplier to document that such funds are being used as agreed or ringfence such payments. Where possible, Buyer and Supplier may cooperate to utilize open book costing approaches to determining price. However, such measures should be feasible in practice and should not put a disproportionate burden on Supplier. Alternatively, parties may also consider a direct payment to the (representatives of) workers or (representatives of) smallholders.

Living wage and living income is defined in the definitions of the EMC in line with the relevant ILO convention and the General Comment 23, para. 18 of the UN Committee on Economic, Social and Cultural Rights (CESCR), living wages are defined as wages "sufficient to enable the worker and his or her family to enjoy other rights in the Covenant, such as social security, health care, education and an adequate standard of living, including food, water and sanitation, housing, clothing and additional expenses such as commuting costs".

Initially, parties may focus their efforts on countries with particularly high poverty rates and low or non-existent minimum wages. That said, the minimum wage should be the starting point.[14] See in this regard also Annex I (points 7 and 17) of the CSDDD which includes the requirement to provide for a living wage (or living income). In exceptional circumstances the minimum wage may be higher than a living wage. In such instances the minimum wage should be the standard.

A more extensive pricing clause may be considered as well. It could read as follows after (i) (and renumbering the current (ii)):

> (ii) At all times, Supplier must be able to document that it is using the price protections in this section to comply with 1.1. Buyer shall have the right to request and inspect this documentation.

The second part of this section (ii) is connected with a material increase of cost of materials used to produce the Good. Especially if Suppliers is a SME's this may trigger Adverse Impacts if it must continue production on the agreed prices. It may, for example, lead to an abuse of workers by demanding excessive overtime to produce more goods within a shorter timeframe in order to compensate for the increased sourcing prices. This section provides for a collaborative approach regarding this issue. In cases where a Buyer lacks leverage to 'dictate' contractual terms or the Supplier is a large entity itself, it may be less necessary to implement this section.

Often Buyer wants to ensure that the payment connected with the material increase of cost is used solely to address these costs. It may ask Supplier to document that such funds are being used as agreed or ringfence such payments.

(d) This section requires commercial terms which enable the implementation of HREDD. Here the observations made in the STTI white paper[15] are relevant that commercial terms like extending the

[14] See also the OECD Guidelines V (Employment and Industrial Relations), V.4.b.

[15] Accessible at https://sustainabletermsoftradeinitiative.com/wp-content/uploads/2022/02/STTI-White-Paper-on-the-Definition-and-Application-of-Commercial-Compliance.pdf. See especially, p. 7.

payment period from 60 to 120 days or asking for retroactive discounts (e.g., in pandemic but way before then, too) creates massive commercial pressures on suppliers who then struggle to pay their workers for work they've already completed.

If specifying the terms mentioned is not commercially feasible at the outset, the parties may agree that they will specify them at a later stage, in full accordance with this section, in order to avoid causing or contributing to Adverse Impacts.

(e) This section relates to order changes and limits the options for Buyer to do so. Parties should see to it that such order changes are commensurate with undertaking HREDD and adjust pricing or timelines if such an order change would result in adverse impacts. Responsible purchasing practices include providing information to the Supplier from the outset of the relationship regarding projections of order quantities and deadlines as well as the required capacity of Supplier. This may be even further elaborated in the following sense as follows:

> (a) From the outset of the commercial relationship, Buyer shall establish a transparent forecasting methodology that results in projections of order quantities and deadlines that take into account Supplier's production capacity and end market demand. To support a high level of accuracy, such methodology shall be based on a sufficient investment in data analysis and demand planning, taking into account relevant geographies, categories, and product designs. Buyer shall share initial and updated forecasts in a timely way to allow Supplier a sufficient time to meet Buyer's revised requirements. Nevertheless, neither forecasts nor projections are binding on Buyer or Supplier unless otherwise agreed.
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> (b) From the outset of the commercial relationship, Buyer and Supplier shall cooperate to establish the capacity of Supplier to meet the requirements of the Buyer. Such cooperation shall include dialogue between Buyer and Supplier and may also include inspections of records and facilities. The result of this process shall be documented. To the extent that Buyer reserves capacity, Buyer shall pay for it in accordance with the contract or, where there is no contract, in accordance with the Supplier's usual rates.

Beyond this, it is also important to collaboratively set reasonable and achievable deadlines. A more elaborate clause regarding this and in addition to Article 1.1 (e) may read as follows:

> Buyer and Supplier agree to collaborate to set reasonable deadlines that take Supplier's capacity into account, and the parties shall agree upon deadlines [___] months in advance of production. Such deadlines and other aspects of the timeline shall be renegotiated as necessary to avoid Adverse Impacts that may result from delays, deadlines, or other timing requirements. If Buyer requires that Supplier work with another company, including but not limited to, for supply of materials or services, Buyer shall be responsible for any delay caused thereby.

(f) Excusable non-performance may, for example, occur if a supplier lacks sufficient personal protective equipment (PPE) to protect its workers in a pandemic to allow for normal operations. This section is intended to address not only change orders but force majeure-like events that go beyond a simple change in conditions affecting a single supplier. It could relate to, but is not limited to, change orders, quantity increases or decreases, or changes to design specifications.

(g) It should be noted that incentives for Suppliers to undertake due diligence may be implemented other than paying a higher price may be implemented. For example, more orders or continuation of a longer lasting relationship may be such incentives. Another important way to achieve this is through collaboration with business peers and undertaking environmental and human rights due diligence a common expectation of multiple buyers.

Positive incentives for Supplier to implement and undertake proper Human Rights and Environmental Due Diligence may be even more productive than sanctions. This section provides for such positive incentives. It may be further elaborated depending on the type of supply chain and assessment of effective positive incentives. Rewards may include, contract renewals, further or expanded orders, contracts of a longer term, investment in increasing Supplier's capacity, or the payment of bonuses.

It is also important that Buyer's evaluation of Supplier with respect to such matters as potential expansion or continuation of the commercial relationship shall give weight to human rights performance equal to criteria such as quality, price, timely delivery, and the like.

Such incentives require an assessment of satisfactory Human Rights and Environmental Performance. Regarding Human Rights performance surveys embedding meaningful stakeholder engagement should be conducted. Regarding broader environmental impact, such as climate change or biodiversity loss, other methodologies may be required. The EU Green Taxonomy provides guidance for such methodologies.

5. Section 1.4

This section is aligned with the UNGPs as an "operational level grievance mechanism" is set up to address problems as they arise. This mechanism is informal, but it is nevertheless required, and it must be fully functional. Again, its purpose—to be "legitimate, accessible, predictable, equitable, transparent, rights-compatible, a source of continuous learning and based on engagement and dialogue with affected stakeholders, including workers"—will align with many companies' efforts toward collaborative supply chain management. Further, it is required for consistency with the UNGPs.

UNGP 29 provides that all businesses must have in place a grievance mechanism to resolve human rights disputes early and directly through engagement and dialogue with stakeholders. It is part of the businesses' ongoing HRDD responsibility. UNGP 22 expects that businesses should cooperate with or participate in legitimate remedial processes when the businesses recognize that they have caused or contributed to an adverse impact. Legitimate processes can include state judicial and non-judicial dispute resolution mechanisms, as well as non-state non-judicial mechanisms. Under UNGP 31, all non-judicial dispute resolution mechanisms, state and non-state, should meet the effectiveness criteria enumerated in the text of the clause.

The Article sets out the obligation of Buyer to establish and maintain an OLGM. The supplier may also maintain its own if it does not participates in Buyers' mechanism. The latter may be more effective in cases in which it has multiple buyers and each maintains its own mechanism. Then a well-functioning supplier level local mechanism may be more effective and open to local stakeholders.

The Article as such does not provide much guidance, except for the referral to UNGP 31, regarding the question how an effective grievance mechanism should look like. The EMCs are not the right place for this. Buyers and supplier should consult experts or relevant institutions for such guidance. That said, a few observations are made. It is important to assess for which stakeholders and which type of complaints the mechanism is intended and to consult relevant stakeholders on the design and functioning of it.[16] However, it should not be overly restrictive in identifying the relevant stakeholders and type of complaints. Buyers and suppliers may consider stakeholder or community driven or multi-stakeholder mechanisms as an alternative.[17] One should also consider how to prioritize complaints if very many are filed in the mechanism. Finally, it is important stakeholders are aware of the mechanism and have meaningful access to it. For example, upfront signing away of rights to engage in other mechanisms should not be a requirement for access. Furthermore, it is important to protect complainants from retaliation, for example, by allowing anonymous complaints and establishing a safe and secure environment to file complaints. Finally, if every buyer of a specific supplier has its own mechanism or sets forth its own requirements, this may be counterproductive not only in terms of the burden this implies for the supplier dealing with many different systems but also in terms of accessibility for rights holders who may not know which mechanism they should use, for example because they are not aware for which buyer they are producing or because they do not trust a mechanism of which they do not know in which manner their complaints are handled and whether and to which extent information regarding claim is shared with the Supplier. Therefore, it is advisable to collaborate with other buyers to establish one or strengthen an existing mechanism at the supplier level. In establishing their mechanisms Buyer and Supplier should pay attention to existing mechanism, such as local mechanisms operated by third parties (NGOs), OECD NCPs or mechanisms established by other buyers. Duplication of mechanisms should be prevented to the extent possible.

In order to maintain open channels of communication Buyer and Supplier may jointly engage with sub-suppliers to assist in building trust of stakeholders in and strengthening of local OLGMs, especially in cases in which they may be linked with severe adverse impacts at this sub-supplier level.

Buyers should collaborate with Supplier to establishing and maintain such mechanisms, amongst other things, depending on the size of the supplier. The smaller a supplier is, the more support should be provided, also in financial terms.

(b) The Article also includes the obligation to provide (aggregated) information on grievances filed in the mechanism. The frequency of providing such information may vary depending on the question whether a high-risk supply chain is involved or not.

(c) It is also important to note that the use of other either judicial or non-judicial mechanisms may not be a prerequisite for using the OLGM referred to in Article 1.4. Likewise, the parties may not agree that the use of it is a prerequisite to engage in other mechanisms or impose such restrictions on those stakeholders desiring to engage in such other mechanisms.

[16] See also Recitals 40 and 65 CSDDD.

[17] Cf. BAFA Guidance ("Zusammenarbeit in der Lieferkette zwischen verpflichteten Unternehmen und ihren Zulieferern - Die wichtigsten Fragen und Antworten für KMU", 1ed June 2023), p. 33.

II. Practical Guidance to Article 1

1. Section 1.1

(a) Article 2(m) of the Conflict Minerals Regulation includes a specific provision on certification. A certification scheme may be approved by the European Commission if it meets the OECD due diligence guidance and pass the OECD alignment test. Undertaking human rights due diligence may be inferred from the engagement in or implementation of an (approved) certification scheme or designated multi-stakeholder initiative is implemented by small or medium sized enterprises. However, participation in such schemes as such does not necessarily raise a presumption of sufficient Human Rights and Environmental Due Diligence as required by the CSDDD (nor the UNGPs or OECD Guidelines). As the CSDDD sets forth companies must assess whether this is the case and can be held responsible in cases in which the initiative is not sufficient to meet the CSDDD requirements.

The Australian Anti-Slavery Commissioner has also issued guidance with due diligence steps to address modern slavery.[18]

(c) The definition of living wage is derived from the ILO definition, accessible at https://www.ilo.org/resource/news/ilo-reaches-agreement-issue-living-wages. To determine an appropriate living wage, parties may consult www.globallivingwage.org, wageindicator.org. or other leading industry benchmarks and data sources relevant to the specific sector(s). Living wage estimates must be updated at least annually. If they provide data in accordance with the definition of living wages. If no reference values are available, the salary can be determined according to a method approved by IDH trade, available at: https://www.idhsustainabletrade.com/idh-living-wage-identifier/. Another method is developed by the UN Global Compact and may be accessed at https://livingwagetool.unglobalcompact.org/.

2. Section 1.2

Technical solutions like blockchain may support establishing and maintaining an environmental and human rights due diligence process, although the blockchain does not itself assess the Human Rights or environmental situation. Blockchain may require that Human Rights and environmental compliance is checked before data may be fed into the blockchain. It is already used by companies to enhance traceability of goods.

3. Section 1.4

To protect complainants against retaliation, one may find relevant guidance in legislation aiming at whistleblower protection, such as Directive (EU) 2019/1937 (Whistle-blower Directive) as well as legislation governing this matter on member state level. One should also note Directive (EU) 2016/943 (Trade Secrets Directive), which provides further guidance on the issue.

Procedural rules have also been developed to protect against retaliation in (arbitral) proceedings. These may serve as an example. One may look at Articles 18(5), 33(3), 38(2)(c), 41(2) and 42(2)(a) of the Hague Rules on Business Human Rights Arbitration[19] and Articles 23(3), 24(4) and 39-41 of the

[18] Accessible at Guidance on Reasonable Steps (nsw.gov.au). Contract clauses regarding modern slavery under Australian law can be accessed via: Due diligence and reporting | Communities and Justice (nsw.gov.au).
[19] Accessible at https://www.cilc.nl/cms/wp-content/uploads/2019/12/The-Hague-Rules-on-Business-and-Human-Rights-Arbitration_CILC-digital-version.pdf.

procedural rules of the dispute resolution mechanism of the Dutch International Responsible Business Conduct Agreements in the Textile sector.[20]

III. Member State specific comments to Article 1, UK and DCFR

1. France

Section 1.1: One should bear in mind that due diligence in France should include a Vigilance, Transition and Remediation plan.

Section 1.3: One should assess whether this clause is commensurate with Article L.442-6 of the Code de commerce.[21] By and large such collaborative contracting is in line with French law.

2. Germany

Section 1.1(a): At least in constellations in which buyers are large firms and suppliers are SMEs the requirements of the BAFA Guidance ("Zusammenarbeit in der Lieferkette zwischen verpflichteten Unternehmen und ihren Zulieferern - Die wichtigsten Fragen und Antworten für KMU", 1ed June 2023)[22] does require more specific provisions on the exact roles both parties have in the exercise of certain due diligence obligations. This could also be argued in other constellations where suppliers are not obliged under human rights and environmental due diligence, especially if they have limited capacity. For example, SMEs might not be expected to do their own full scale risk analysis but could rather rely on information given to them by buying firms and collaborate in buyer`s risk analysis as requested. This could also be derived from the LkSG requirements on adequacy and effectiveness, as well as under the reasonableness requirement that applies for the use of standard terms (Sec. 307).

Section 1.1(d): Business practice in Germany is using annual questionnaires to a risk-based selection of suppliers as regular information channel and ad hoc requests for specific risk situations. The buyer might also be required to take a cooperative approach on this, amongst others, accepting other standard questionnaires and scorecards that suppliers might have filled out ("Once-only") and that include the relevant information on their risk situation to avoid over-bureaucracy.

In a supply chain where a supplier typically has a low number of buyers, the information right might be feasible. However, where suppliers have many buyers, this creates a big bureaucratic burden as the supplier would have to invest a lot of time in communicating the same violation to many buyers. That might also lead to problems under German contract law (unreasonable commercial terms and

[20] Accessible at https://www.imvoconvenanten.nl/en/garments-textile/agreement/-/media/3670C016696D4456A9AB82DEAD9E88E4.ashx. See also https://www.ser.nl/en/themes/irbc/complaints-disputes-committee for the decisions of this mechanism. The International Responsible Business Conduct Agreement in the Natural Stone sector includes comparable instruments in Articles 10(4), 23(3), 24(4), 26(3) and 39-41. These rules are accessible at https://www.imvoconvenanten.nl/en/trustone/initiatief/-/media/5EEE6797C4A846F39A6A7EC0818B8A31.ashx.

[21] As modified by the loi Hamon du 17 mars 2014.

[22] Accessible at https://www.bafa.de/SharedDocs/Downloads/EN/Supply_Chain_Act/guidance_cooperation_supply_chain.html?nn=1469788.

conditions can be voided under Sec. 307 of the German Civil Code). In cases of smaller violations, suppliers might also be able to handle them alone and quickly (e.g. small breaches of workplace protection rules). Therefore it might generally or at least in the described situations be more recommendable to restrict this information obligation for individual cases to severe violations and otherwise only require summaries, for example on a yearly basis.

Monthly or quarterly reports are likely to be considered too burdensome and potentially inadequate for suppliers, especially SMEs under Sec. 307 of the German Civil Code, if not justifiable by a very high-risk situation of the supplier - if a supplier has many buyers, this provision would require them too very burdensome and time-intensive reporting.

Section 1.2: This section may enable the buyer to retrieve information regarding the supplier`s suppliers which may enable it to exclude the supplier by making direct contracts with the supplier's suppliers. This may render the clause void under German Law under the General Terms and Conditions Law and may create an incentive for suppliers to not conclude contracts. In order to make this clause commensurate with German law one may consider a cooling off period in which the buyer is not allowed to contract with a supplier`s suppliers or other types of safeguards, like giving the supplier the right to propose disclosure to trusted third parties as clearing.

Section 1.3: These provisions have a very high relevance for fulfilling the obligations on responsible purchasing under Sec. 6 (3) No. 2 LkSG. It should be noted that the usage of this clause might not be required under LkSG in situations of power imbalances between small buyers and big buyers.

Section 1.4: The German Supervisory authority BAFA requires Buyers to implement a grievance mechanism. BAFA considers a mechanism at the Supplier level optional. This implies, where supplier is not obliged by LkSG, LdV, Norwegian Transparency Act or similar, requiring them only to participate in Buyer`s mechanism and alternatively establishing their own mechanism or participating in an external one, if these alternatives meet the requirements of Sec. 8 LkSG or UNGP 31.

3. Italy

Section 1.1: As far as Italian data protection rules are concerned, in addition to the GDPR, the matter is governed by the Italian privacy code, which is Legislative Decree No. 196 of June 2003; the Parties might wish to refer to this legislation in the contract and will have to ensure compliance of the due diligence process with such rules.

Section 1.3: Under Italian law (articles 1337 and 1375 of the Italian Civil Code), in the negotiation phase and during the drafting and the performance of the agreement, the parties shall act in good faith. The violation of such good faith obligation may give rise to contractual liability of the defaulting party, and an obligation to pay damages as a consequence. Buyers should consider such Italian provisions especially with regard to section 1.3(d) (*Modifications*) and section 1.3(f) (*Responsible Exit*).

Furthermore, and unless specifically approved in writing by means of a double signature (*doppia sottoscrizione*), general terms that establish, in favor of the party which drafted them, limitations of liability, the right to withdraw from the contract or suspend its execution or provide for the other

party the penalty of forfeiting rights, limitations on the right to oppose exceptions, restrictions on contractual freedom in dealings with third parties, tacit extension or renewal of the contract, arbitration clauses or exceptions to the jurisdiction of the judicial authority, are not valid under Italian law.

While the concept of 'commercially reasonable efforts' (as opposed to best efforts/reasonable best effort or other similar concepts) is sufficiently defined in certain jurisdictions, corresponding precise standards do not exist in the Italian legal system, which mostly differentiate between so-called obligations of means (*i.e*. also known as obligations of diligence, which consists in the diligent use of the means at debtor's disposal to perform a certain activities without ensuring the final result (*e.g.*, the obligations of a lawyer in court) and obligations of result (the debtor undertakes to achieve a specific result)). Therefore, the parties might rely on such language, (*e.g.*, the Supplier/Buyer undertakes to take all necessary steps in order to […] / undertakes to diligently pursue…) although the precise scope of such obligation may vary depending on the specific circumstances.

4. Poland

Section 1.2: Polish contract law is obviously based on the principle of privity of contracts, but this does not prevent one party from promising the other that it shall enter into certain contractual relationships with third parties or from guaranteeing that certain third parties will act in a certain manner.

Section 1.3: Buyer's obligations as envisaged by this clause add balance to the contractual relationship. Removing them may create the risk of the contract falling foul of legislation aimed at preventing abuses of contractual power (such as e.g. the Polish Act on countering unfair use of contractual power in trade of agricultural and food products).

5. Portugal

Section 1.1: One should be aware that the collabouration as envisaged by Article 1.1 does not to violate Law 19/2012, of 08 May (Portuguese Competition Law), notably Article 9 on Agreements, concerted practices and decisions by associations of undertakings, Article 11 on Abuse of a dominant position and Article 12 regarding Abuse of economic dependence. One should bear in mind Article 406(2) of Decree-Law 47344/66, of 25 November (Civil Code)[23] on the effectiveness of contracts.

Section 1.3: Portuguese law foresees a set of limitations concerning general contractual clauses drafted without prior individual negotiation, which tenderers or undetermined addressees limit themselves to subscribing or accepting, respectively, as well as concerning clauses inserted in individualised contracts, but whose previously prepared content the addressee cannot influence.

It should be safeguarded that a party to an agreement cannot use its leverage to push for disproportionate commitments and rights where the other party did not have the opportunity to negotiate the terms of the agreement at hand.

[23] Accessible at DL n.º 47344/66, de 25 de Novembro (pgdlisboa.pt)https://www.pgdlisboa.pt/leis/lei_mostra_articulado.php?nid=837&tabela=leis&so_miolohttps://www.concorrencia.pt/sites/default/files/documentos/legislacao/Law_19_2012_bilingual_en_0.pdf.

Notably, the following general contractual clauses are always null and void:

- Clauses contrary to good faith;
- Clauses that directly or indirectly exclude or limit monetary damages arising from tort;
- Clauses that directly or indirectly exclude or limit contractual liability in case of fraud or wilful misconduct;
- Clauses that exclude termination of the agreement by breach.

The burden of proof regarding a contractual clause which has originated from prior negotiation between the parties (and, thus, is not null and void) falls upon whoever intends to take advantage of its content.

In this context, to the extent that the terms of the model clauses may be imposed with little to no negotiation from the counterparty, and to the extent that the model clauses trigger any of those forbidden clauses (e.g., by rendering termination of the agreement too cumbersome and, thus, in practice excluding it), they are null and void.

See regarding this also Decree-Law 446/85, of 25 October (General Contractual Clauses Regime)[24] and notably Articles 18 (Clauses prohibited in all cases) and 19 (Clauses prohibited in certain circumstances).

6. Spain

Section 1.1(d): As regards the content of the "qualitative and quantitative" information to be provided by the Supplier to the Buyer, to the extent that Buyer and Supplier could be actual or potential competitors in a market (which might be the case especially in no linear supply relationships), due attention should be paid to avoid any exchange of information which could be commercially sensitive according to the relevant antitrust laws and regulations, basically meaning information which may influence the way the Buyer or the Supplier would act in such particular market, as this may amount to a breach of Article 1 of Spanish Antitrust Law 15/2007 of 3rd of July and/or Article 101 of the Treaty on the Functioning of the European Union. To further prevent any potential antitrust breach in those cases where Buyer and Supplier may be competitors, clean teams may be set up to exchange any sensitive information which might be necessary to the human rights and environmental due diligence process.

The Spanish and European provisions on data protection must also need to be taken into account to implement the proper security mechanisms in the event that the anticipated exchange of information involves personal data.

Section 1.2: The concept of "best effort" (or "commercially reasonable efforts" qualifies under Spanish law as an undefined legal concept ("*concepto jurídico indeterminado*") which shall be interpreted taking into account the circumstances surrounding the discharge of the obligation. It must be born in mind that according to Spanish case law this clause could also be interpreted as creating an obligation of result, and not of means.

[24] Accessible at DL n.º 446/85, de 25 de Outubro (pgdlisboa.pt)https://www.concorrencia.pt/sites/default/files/documentos/legislacao/Law_19_2012_bilingual_en_0.pdf.

Section 1.3(a): The concept “fair”, as it is drafted in this Article, can be interpreted in very broad terms under Spanish law and, therefore, can be potentially troublesome. As the Spanish Civil Code already contemplates in article 1546 that all contracts must be discharged in good faith, we would suggest to delete the reference to this term (“fair”).

Section 1.3(c): If Buyer and Supplier are actual or potential competitors this clause is especially sensitive in the sense indicated in the comment to Article 1.1(d).

Section 1.3(f): the wording of this clause may introduce an excessive uncertainty about the enforceability of the contract and the rights of the parties and in this sense it would be advisable to introduce an element of objectivity in its application like, for example, deferring to the assistance of a third party opinion on the possibility of its triggering.

Furthermore, contractual parties should be aware that contractual terms establishing limitations on contractual liability are not enforceable in the event of wilful intent (“*dolo*”).

7. UK

8. Draft Common Frame of Reference (DCFR)[25]

Section 1.3: seems also to be commensurate with principle 43 of the DCFR that one may not take undue advantage of the (economic) position or lack of expertise of the other party.

(c) This section may also serve to satisfy the demands of Article II-9:105 regarding grossly unreasonable contract prices determined by one party and to prevent unfair standard terms between business as referred to in Article II-9:405.

(f) This section may be suspect under Article III-3:105(2) if non-termination would violate good faith and fair dealing. However, it is expected that this would rarely happen. It may also be contrary to Article III-3:502 if non-performance is fundamental, which may be the case regarding human rights violations. However, one may argue this section in the EMCs is connected with providing the supplier a period of time to cure the non-performance, which is allowed under Article III-3:202. Furthermore, one should realise that the occurrence of an Adverse Impact as such does not implicate a breach of this Agreement. This will be the case only if this would result from deficient Human Rights and Environmental Due Diligence as required by this Agreement or when one of the parties fails to implement remediation measures as required by this Agreement.

[25] Accessible at https://www.law.kuleuven.be/personal/mstorme/2009_02_DCFR_OutlineEdition.pdf.

Article 2

I. General commentary to Article 2

1. Introduction

Because everyone should contemplate remediation of Adverse Impacts in almost all circumstances, this Article provides for remediation. In addition, remediation is not solely the responsibility of the Supplier; the Buyer must participate if it has caused or contributed to the problem. These provisions are not only in keeping with the shared responsibility of buyers and suppliers but also seem especially appropriate in cases where the buyer has caused or contributed to the harm.

It is important to realize that the occurrence of an Adverse Impact will not automatically imply a breach of the Agreement. For example, Buyer and Supplier may have implemented sufficient Human Rights and Environmental Due Diligence but may not have prevented an Adverse Impact further down the supply chain. Furthermore, an Adverse Impact at the Supplier level may also be contributed by the Buyer and, thus, may not be a (sole) breach of the Supplier. Therefore, this Article does not frame Adverse Impacts as such as a breach of the Agreement but sets forth that a corrective action plan has to be established and implemented (within the cure period) if the Adverse Impact cannot be cured right away. Obviously, a breach may occur, for example if Buyer or Supplier have not undertaken Environmental or Human Rights due diligence in accordance with Article 1.1 or when Buyer or Supplier does not comply with Article 2. However, remedies for such breach are implemented in Article 3.

The foregoing is elaborated in the following:

> (i) An Adverse Impact is not caused by a breach → Corrective Action Plan (Section (a)) is required, if this Remediation Plan is not executed this results in a breach and triggers the remedies of Article 3.
>
> (ii) An Adverse Impact is caused by a breach (for example, Supplier has not implemented or refuses to collaborate to implement proper Human Rights and Environmental Due Diligence and deploys irresponsible purchasing practices vis-à-vis subcontractors) → Corrective Action Plan is required and this may trigger the remedies of Article 3 (including termination and responsible exit).
>
> (iii) A breach has occurred but no Adverse Impact → The remedies of Article 3 are triggered (including termination and responsible exit)
>
> (iv) If a Corrective Action Plan fails not due to a breach by either Buyer or Supplier (for example regarding adverse impacts further down the supply chain) parties shall negotiate in order to find a solution to address the impact effectively. If they fail to reach an agreement the dispute resolution mechanism of Article 5 is triggered.

It is important to note that this Article only governs the situation in which an Adverse Impact has occurred.

2. Section (a)

Under UNGP 24 businesses are entitled to prioritize and focus their attention on the most severe human rights harms or harms that become irremediable if there is a delayed response. A 'severe harm' is characterized by its gravity, the number of people that are or will potentially be affected, and the ability to make people whole. The severity of an Adverse Impact furthermore depends on the extent of the damage or potential damage to, or other effects on, the environment, the irreversibility of the impact and any limits on the ability to restore affected individuals or the environment to a situation equivalent to their situation prior to the impact. See also UNGP 14 defining in commentary what contributes to the severity of harm. Therefore, the Corrective Action Plan should consider the severity of the impacts and prioritize the most severe ones.

Parties should be aware that the national laws of the country in which either Buyer or Supplier has its seat may require the communication of such information to either a public supervisor or in non-financial reports.

It is important to note that remediation is both retrospective and prospective. It is retrospective because it attempts to make people whole for the harm they have suffered. It is prospective because it seeks to prevent recurrence. In this way, remediation is embedded within corporate sustainability due diligence. The forms of remediation in the clause are based on the commentary to UNGP 25.

Parties should secure that affected Stakeholders and/or their representatives have participated in the development of the Corrective Action Plan and are being regularly consulted in the implementation of the Remediation Plan. Articles 11(3)(b) and 13 of the CSDDD requires the development of a Corrective Action Plan in consultation with stakeholders.[26] Annex II to the Conflict Minerals Regulation[27] also includes an obligation to engage in a dialogue with the supplier, those impacted, local and national authorities and NGO's and to agree with those stakeholders on a plan to remediate this impact and to assess the effects of the plan in a measurable way, if a human rights impact is observed and the contract is not terminated or suspended.

Article 11(3)(b) of the CSDDD requires such a remediation plan if the Adverse Impact cannot be immediately brought to an end. If an adverse impact cannot be brought to an end in a supply chain. Recitals 38 and 53 of the CSDDD clarify that companies should minimize the extent of such impacts where adverse impacts cannot be brought to an end, which requires an outcome which is the closest possible to bringing an adverse impact to an end. Recital 54 further elaborates this. The action to end or minimize the impact should be proportionate to the significance and scale of the adverse impact as well as the contribution of the companies conduct.

Pursuant to Recital 54 of the CSDDD the buyer should also provide targeted and proportionate support for an SME which is a business partner of the company, where necessary in light of the resources, knowledge and constraints of the SME, including by providing or enabling access to capacity-building, training or upgrading management systems, and, where compliance with the code of conduct or the corrective action plan would jeopardise the viability of the SME, providing targeted

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[26] See also Recitals 40 and 65 CSDDD.

[27] Regulation EU 2017/821, https://publications.europa.eu/en/publication-detail/-/publication/8b0e378b-3c59-11e7-a08e-01aa75ed71a1/language-en/format-PDFA1A. This regulation is based on The *OECD due diligence Guidance for Responsible Supply Chains of Minerals from Conflict-Affected and High-Risk Areas*, accessible at https://www.oecd.org/corporate/mne/GuidanceEdition2.pdf.

and proportionate financial support, such as direct financing, low-interest loans, guarantees of continued sourcing, or assistance in securing financing. The notion of 'Jeopardising the viability of an SME' should be interpreted as possibly causing a bankruptcy of the SME or putting the SME in a situation where bankruptcy is imminent.
Recital 55 of the CSDDD explains that a buyer may also seek contractual assurances from an indirect business partner.

The OECD Due Diligence Guidance recommends remediation be risk based, prioritizing the most severe risks for corrective action.[28] In cases where it is not possible to bring to an end or mitigate all identified Adverse Impacts simultaneously, companies may prioritize the order in which they take appropriate measures. They should do so on the basis of the severity and likelihood of impacts and in a manner informed by meaningful engagement with affected stakeholders.[29] The company's degree of influence, leverage over or proximity to the subsidiaries or entities with which it has a business relationship is not relevant for its prioritization decisions.

The appropriate remediation will depend on the nature and extent of the harm and the prioritization of risk. For example, many buyers choose to rate forced labor and child labor as high risk. Buyer may refuse Goods originating from a factory where such breaches have taken place and may require rigorous comprehensive remediation of that factory while maintaining the contract with other factories operated by Supplier when appropriate.

The term capacity building is found in the OECD glossary of statistical terms as the '[m]eans by which skills, experience, technical and management capacity are developed within an organizational structure (contractors, consultants or contracting agencies)—often through the provision of technical assistance, short or long term training, and specialist inputs (e.g., computer systems). The process may involve the development of human, material and financial resources.'[30]

The timeline to be implemented in the Corrective Action Plan depends on the type of Adverse Impact. The more severe or irreversible an impact is or the larger its scale, the faster it should be remediated.[31] One should realize that remedy might be difficult to achieve and originally set timeframes might prove unrealistic, especially in relation to complex cases in which remedy has to be provided. The German Act therefore requires the remediation plan to consist of a timetable with different measures to be implemented and objectives to be achieved. Similarly, Article 11(3)(b) requires "reasonable and clearly defined timelines for action" and "qualitative and quantitative indicators for measuring improvement". Parties should also assess already achieved objectives and

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28 OECD Due Diligence Guidance, supra note 8, at 34–35, Annex Questions 41-45 and 48-54, accessible at http://mneguidelines.oecd.org/OECD-Due-Diligence-Guidance-for-Responsible-Business-Conduct.pdf.

29 See also Recitals 40 and 65 CSDDD.

30 Glossary of Statistical Terms: Capacity Building, OECD, August 22, 2002, accessible at https://stats.oecd.org/glossary/detail.asp?id=5103.

31 Cf. the ruling of the Dispute Resolution Mechanism of the Dutch International Resonsible Business Conduct Agreement in the Textile Sector of 17 May 2021, para. 5.20 accessible at https://www.ser.nl/en/themes/irbc/-/media/FC631EE30DF7407583EF96608E14E49F.ashx and the ruling of 31 May 2022, para. 5.14 accessible at https://www.ser.nl/en/themes/irbc/-/media/A40B54F014DC4F3E9EAA36713487CCE7.ashx.

reassess timeframes. They should not terminate just because remedy they believed was possible until a certain moment in time takes longer to achieve.

Before the Remediation Plan can be deemed fully implemented, parties shall secure that affected Stakeholders [and/or their representatives] have participated in determining that the Remediation Plan has met the standards developed under this clause.

Parties may contemplate to implement a dispute resolution option (including a binding escalation mechanism) with rights holders affected by the Adverse Impact in the remediation plan. This is further elaborated in Article 5.

This Article has been drafted broadly to provide Buyer and Supplier flexibility in crafting an appropriate industry-specific protocol for addressing Adverse Impacts by Supplier.

3. Section (b)

The OECD Guidelines (as well as the UNGPs) concern those adverse impacts that are either caused or contributed to by the enterprise, or are directly linked to their operations, products, or services by a business relationship.[32] The OECD Guidelines further provide that an enterprise 'contributes to' an adverse impact or harm if its activities, in combination with the activities of other entities, cause the impact, or if the activities of the enterprise cause, facilitate, or encourage by incentives another entity to cause a harm and is not limited to minor or trivial contributions.[33] As stated there, the term 'business relationship' includes relationships with business partners,' including franchisees, licensees, joint ventures, investors, clients, contractors, customers, consultants,' advisers, entities in the supply chain, and 'other non-State or State entities directly linked to its business operations, products or services.'[34] The OECD Guidelines further provide that where a harm is directly linked to the operations, products, or services of a business, the business must use its leverage to influence the entity causing the harm to prevent or mitigate it.[35] Under UNGP 22 businesses are responsible for participating in remedy for affected stakeholders where they caused human rights harm directly through their own operations and where they contributed to harm caused by others. A party can be deemed to have contributed to an actual Adverse Impact if it violated Articles 1.1-1.3 and such violation was a significant contributing factor to the actual Adverse Impact in question. It is conceivable that both parties have caused or contributed to the same actual Adverse Impact. For example, where Buyer fails to take reasonable action to address an Adverse Impact promptly after becoming aware of it, Buyer may become involved in a situation where it contributes to any ongoing harm next to the Supplier. However, this will depend on the circumstances of the case.

Recital 53 of the CSDDD further elaborates the term 'jointly causing' in line with the previous instruments.

4. Section (c)

Regardless of Buyers' contribution it should provide adequate assistance. Next to the measures mentioned in this section cooperation among buyers who all purchase from the same troubled

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32 See paragraphs A.11 and A.12 of the OECD Guidelines. See also OECD Due Diligence Guidance, at 20.

33 See OECD Due Diligence Guidance, at 23.

34 OECD Due Diligence Guidance, at 10 and 23.

35 OECD Due Diligence Guidance, at 24.

supplier can be especially effective. The Corrective Action Plan may therefore include multiple Buyers and the division of measures and cost may be shared between multiple parties. However, buyers should keep in mind the European and member state competition laws. The European Commission currently prepares horizontal guidelines which provide guidance on the type of collaboration allowed between buyers to incentivize sustainability measures and, thus, also regarding such collaboration. Some member state competition authorities have done the same. In this regard Article 11(5) of the CSDDD as well as Recitals 49 and 50 include the option to conclude a contract with an indirect business partner in order to secure the implementation of a remediation plan. The contract should not preclude this based on competition law.

5. Section (d)

If termination of the Agreement is part of the Corrective Action Plan, parties should see to a responsible exit. Human rights remediation should not build on termination as current contractual mechanisms often do. Recital 50 of the CSDDD states that the buyer should prioritise engagement with business partners in their supply chains instead of terminating a relationship. Termination should be a last resort after attempting to prevent and mitigate adverse (potential) impacts without success. That said and pursuant to Recital 50, if a potential adverse impact cannot be addressed by appropriate measures the buyer should as a measure of last resort refrain from entering into new or existing relations with the supplier in question and, where there is a reasonable prospect of change, by using or increasing buyers leverage through the temporary suspension of business and adopt and implement an enhanced prevention action plan. However, according to Recital 50 it should assess whether this would lead to additional adverse impacts on SMEs or smallholders.

However, usually parties would not actually move to termination except in the rarest and most egregious circumstances.[36] Beyond this, termination often worsens the human rights or environmental situation.[37] Therefore, this section requires remediating the problem by taking measures to stop and correct the harm and to address any grievances. Termination usually is in no one's interest. The buyer does not want to suffer the disruption and incur the delay or switching costs to transfer its business to new suppliers. The supplier certainly does not want to lose business. And except in the most extreme circumstances, the workers do not want to lose their jobs and their livelihood.

Articles 10(6) and 11(7) CSDDD and Recitals 50 and 57 confirm that companies should continuously engage with their business relations and disengagement is a measure of last resort. Recital 50 and 57 also allow prioritizing engagement with business relationships in value chains instead of termination as a last-resort action after unsuccessfully attempting to prevent and mitigate adverse impacts. If the adverse impact cannot be brought to an end Articles 10(6) and 11(7) CSDDD and Recitals 50 and 57 also refer to the obligation to suspend commercial relationships if it is expected to be successful on the short-term or terminate if the potential impact is severe. Articles 10(6)(a) and 11(7)(a) CSDDD also require implementation of an enhanced prevention/corrective action plan before an envisaged exit is allowed, this is implemented in Article 3.1(a).

[36] See also the commentary to the OECD Guidelines to II (General Policies), para. 25, See also the OECD Guidelines V (Employment and Industrial Relations), V.6.

[37] See also Recitals 50 and 57 CSDDD.

Recital 57 further elaborates the enhanced corrective action plan. It should include a specific and appropriate timeline for the adoption and implementation of all actions therein, during which the company may also seek alternative business partners. Factors determining the appropriateness of the timeline for adoption and implementation of those actions could include the severity of the adverse impact, the need to identify and take steps to bring to an end or minimise the extent of any additional adverse impacts, as well as impacts on SMEs or smallholders. Companies should suspend their business relationships with the business partner, thereby increasing their leverage and increasing the chances that the impact is addressed. Where companies temporarily suspend or terminate the business relationship, they should take steps to prevent, mitigate, or bring to an end the impacts of suspension or termination, provide reasonable notice to the business partner and keep that decision under review.

Recitals 50 and 57 of the CSDDD clarify that it is possible that bringing to an end adverse impacts at the level of indirect business relationships requires collaboration with another entity. In some instances pursuant to Recital 57, collaboration with another company could be the only realistic way of bringing to an end actual adverse impacts at the level of indirect business relationships, in particular where the indirect business partner is not ready to enter into a contract with the company.

In cases where it is not possible to bring to an end or mitigate all identified Adverse Impacts simultaneously, companies may prioritize the order in which they take appropriate measures. They should do so on the basis of the severity and likelihood of impacts and in a manner informed by meaningful engagement with affected stakeholders.[38] The severity of an Adverse Impact should be determined based on its gravity, the number of individuals that are or will be affected, or the extent of the damage or potential damage to, or other effects on, the environment, whether the impact is irreversible and any limits on the ability to restore affected individuals or the environment to a situation equivalent to their situation prior to the impact. The company's degree of influence, leverage over or proximity to the subsidiaries or entities with which it has a business relationship is not relevant for its prioritization decisions.

Buyer may have to provide support to prevent additional Adverse Impacts and bear part of the cost made by Supplier if Supplier is an SME or, pursuant to Article 3.4, if Buyer has caused or contributed to the Adverse Impact.

Furthermore, this section is commensurate with the obligations set forth by Articles 10(6) and 11(7) CSDDD. Recitals 50 and 57 of the CSDDD clarifies that where there is no reasonable expectation that those efforts would succeed, for instance, in situations of state-imposed forced labour, or where the implementation of the enhanced corrective action plan failed to bring to an end or minimise the extent of the adverse impact, the company should be required to terminate the business relationship with respect to the activities concerned if the actual adverse impact is severe. In order to allow companies to fulfil that obligation, Member States should provide for the availability of an option to terminate the business relationship in contracts governed by their laws. In deciding to terminate or suspend a business relationship, the company should assess whether the adverse impacts of doing so could be reasonably expected to be manifestly more severe than the adverse

[38] See also Recitals 40, 44 and 65 CSDDD.

impact that could not be brought to an end or the extent of which could not be adequately minimised.

II. Practical Guidance to Article 2

1. Section (a)

The responsibilities of Supplier and Buyer as set forth by Articles 2 and 3 in connection with Adverse Impacts and breaches of the agreement, as depicted in the scheme in the introduction of the general commentary may be further elaborated. For example, Buyer and Supplier should prepare a scheme regarding the required information (also regarding sub-suppliers if needed) and financial, technical and human recourses as well as on the division of cost of the measures connected to the Remediation Plan.[39]

Further practical guidance as how to divide cost between Buyer and Supplier as well as indicators to assess Buyer's contribution can be found in the BAFA Guidance.[40]

As the Corrective Action Plan is primarily designed for rights holders (third parties to this Agreement), this raises the question whether any third-party rights to affected stakeholders should be granted in the Remediation Plan. Third-party beneficiaries are a controversial issue. One may either grant no such Third-Party Beneficiary rights, choose an in between solution or grant such rights.[41] Ideally, all adversely impacted stakeholders would be granted enforcement rights under this Agreement or more specifically in connection with a Remediation Plan, but there are significant commercial and practical obstacles to granting such third-party beneficiary rights.

Article 11(3)(h) and 12 CSDDD does not directly seem to require implementing such third-beneficiary rights in a supply chain contract. However and obviously, this article definitely allows for such a provision. Moreover, one should realize that Article 29 CSDDD provides access to remedy for affected rightsholders for breaches of Articles 10 and 11 CSDDD regardless of whether parties have granted such third-party rights in the agreement.

If parties wish to include such rights in a remediation plan (or more broadly), they may consider the language proposed in Corporate Accountability Lab.[42] It reads:

> (a) The Parties to this Agreement acknowledge and agree that the terms of this [Agreement][Remediation Plan] are intended to benefit and protect not only the Parties but also persons directly impacted by (1) Supplier's and/or Buyer's activities performed under this [Agreement][Remediation Plan] and (2) activities by sub-suppliers that the Supplier contracts with to perform under this [Agreement][Remediation Plan]. Such persons include but are not limited to workers, landowners, property owners, those residing, working, and/or recreating in

[39] Cf. BAFA Guidance ("Zusammenarbeit in der Lieferkette zwischen verpflichteten Unternehmen und ihren Zulieferern - Die wichtigsten Fragen und Antworten für KMU", 1ed June 2023), p. 4, 26, 29 and 30.

[40] BAFA Guidance ("Zusammenarbeit in der Lieferkette zwischen verpflichteten Unternehmen und ihren Zulieferern - Die wichtigsten Fragen und Antworten für KMU", 1ed June 2023), p. 30 and 31.

[41] The ultimate decision may be affected by the outcome of discussions with respect to a possible mandatory treaty on business and human rights. See The Third Revised Draft of a Treaty on Business and Human Rights by the Open-Ended Intergovernmental Working Group on Transnational Corporations and other Business Enterprises with respect to Human Rights (OEIGWG), established by U.N. Human Rights Council Resolution 26/9 (Aug. 6, 2020).

[42] See Towards Operationalizing Human Rights and Environmental Protection in Supply Chains: Worker-Enforceable Codes of Conduct, February 2021, https://static1.squarespace.com/static/5810dda3e3df28ce37b58357/t/6026fd326aa9cd4f88697a20/1613167923256/Towards+%20Operationalizing+Human+Rights+and+Environmental+Protection+in+Supply+Chains.pdf.

proximity to supply chain activities who are injured or suffer damages due to Adverse Impacts, including survivors of those killed or disabled. Such persons are intended third-party beneficiaries to this [Agreement][Remediation Plan].

(b) All intended third-party beneficiaries of this [Agreement][Remediation Plan] have the right to enforce this [Agreement][Remediation Plan] against Parties in any court or tribunal that has jurisdiction over the [Buyer/Supplier or Agreement/Remediation Plan].

(c) Third-party beneficiaries may assign their rights to or may be represented by a labor union, nongovernmental organization, or other organizations providing legal assistance they select.

If this language is adopted it is necessary to consider its relation to other dispute resolution mechanisms and parties should note in particular Article 5. For example, it may be helpful to implement a system of dialogue-based dispute resolution with rightsholders paired with an escalation mechanism if the dialogue fails (either in national courts or through arbitration) as envisaged by Article 5. That said, recourse to existing dispute resolution mechanisms, such as the International Accord in the Garment Sector, the ACT mechanism and National Contact points of the OECD, may be an option too. In case such existing mechanisms are deployed parties should decide how, and implement language on, the decisions of these mechanisms should be dealt with in view of their contractual obligations.

The Australian Modern slavery guidance also includes some language on third party beneficiary rights.[43] It also includes clauses regarding it.[44]

2. Section (d)

The former Bangladesh Accord (currently: International Accord) provided some additional guidance on responsible exit.[45] It included three stages. First a letter should be sent to the supplier management to inform it, it is in breach of the remediation plan and to give a specified number of days to bring about specified improvements, if these are implemented no further steps are necessary. If not, the management of all the brands sourcing from the factory send a warning letter to the supplier, stating that if the steps specified in the remediation plan are not taken within a specified number of days these brands are legally required to terminate the relationship. At this point the Accord Secretariat, the supplier and the brands to explain how disengagement should proceed, if necessary, and to determine whether additional financial commitment from the brands is required. The third step is responsible disengagement if the requirements of the remediation plan are not met within the specified time. This implies collective disengagement by all Accord brands. However, the brands are still responsible for compensating workers for termination of work resulting from disengagement, but no longer for other cost. This implies, for example, that the disengaging brands are expected to temporarily pay workers' salaries, and the brands have to make reasonable efforts to find alternative employment for the workers as the working environment is unsafe in such cases. This is especially important for union leaders who may have pointed at the

[43] Accessible at Guidance on Reasonable Steps (nsw.gov.au)

[44] They may be accessed at: Due diligence and reporting | Communities and Justice (nsw.gov.au).

[45] The Bangladesh Accord 'escalation protocol' for responsible engagement and disengagement. See on this OECD Watch, Legislating due diligence: Respecting rights or ticking boxes?, p. 26, accessible at https://www.somo.nl/respecting-rights-or-ticking-boxes/.

issue and may be blacklisted. Blacklisting results in difficulty in finding future work. In such cases the Accord may also intervene. The supplier then remains blacklisted for 24 months and may reapply after that. That said, in case of acute fire or building danger the escalation protocol may be skipped and a buyer may immediately move to disengagement. This is an interesting example as it uses collective leverage of buyers sourcing from a specific facility to increase the credibility and eloquence of the threat of disengagement, which is a more powerful instrument than such a threat expressed by a single buyer. This is not a feature which as such can be included in model supply chain contracts, but it can be part of multi-stakeholder initiatives and collaboration between buyers to increase leverage. It should also be noted that disengagement does not terminate responsibilities of the buyer towards workers, especially regarding their compensation and, if applicable, reasonable efforts to find alternative employment for them. Beyond this, a model contract may include a provision stipulating that the buyer will not reengage with the supplier during a specified period of time, for example, 24 months. This also increases the threat of disengagement. It is to be expected that European multi-stakeholder initiatives, such as the Dutch International Responsible Conduct Agreements and the Fair Wear Foundation, may consider and implement this disengagement approach as a best practice.

The OECD Due Diligence Guidance also provides helpful guidance on responsible exit.[46]

[46] See p. 31 and Q39, accessible at https://mneguidelines.oecd.org/OECD-Due-Diligence-Guidance-for-Responsible-Business-Conduct.pdf. See also the guidance on Modern Slavery

III. Member State specific comments to Article 2, UK and DCFR

1. France

If a third-party beneficiary clause is implemented one should note that Article 1200 of the French Code Civil rules that contractual rights may only be exercised between parties. Therefore, third-beneficiary rights are challenging. That said, these third parties may have a tort claim against the Buyer or the Supplier based on the Adverse Impact.

2. Germany

Under the new Guidance of Helpdesk & BAFA (Executive Summary Collabouration in the Supply Chain, 1st ed June 2023, p. 5), buyers are generally obliged to participate in the costs of preventive and remedial measures according to the adequacy criteria - i.e., it might be that suppliers or buyers have to share the costs, esp. depending on the contributions to violations that are found and according to capacity of each. Relieving SMEs of costs for investigations is generally in line with that, but an addition referring to the adequacy criteria would be helpful. It might be a good idea to let suppliers pay where violations are found that the buyer did not contribute to. The same reasoning should apply for remediation plans.

Third-party rights are not addressed by the EMC, but might be in need of addressing. As to the EMC choice of leaving the issue of third-party rights untouched, this should be possible under German law. According to § 328 (2), the absence of any specific agreement by the party would leave it to the courts to interpret the intention of the parties in the light of the circumstances and the contractual purpose. Given that the EMC have the purpose of protecting others than the contracting parties, it is possible that a court would agree that third-party rights derive from the contract. German law also contains another, quite specific, version of third-party rights: The contract with protective effect vis-à-vis third parties (Vertrag mit Schutzwirkung zugunsten Dritther). This category has been developed by the courts in analogy to the rules on contract with third party rights. The contract with protective effect vis-à-vis third parties is a category that creates protective duties towards a narrow group of protected third parties that are related to the contract, where one of the parties has an interest in including the third party (because of an obligation to protect), where inclusion is foreseeable for the contracting parties and the third party is in need of protection. Claims based on a contract with protective effect only cover breaches of protective duties and thus are more akin to tort claims than to contract claims. To consciously regulate this issue and not leave it to deciding courts, third party rights could be explicitly excluded or explicitly included. In fact, while under German law, it is also possible for third parties suffering from non-compliance with EMC to file a claim under tort law (§ 823 BGB), the narrowness of German tort law (in requiring breach of one of the enumerated rights, default and negligence) makes this rather difficult. The contract with protective effect vis-à-vis third parties is a possible contractual solution. Finally, regardless of whether the clauses create or not create third party rights, German law always requires determining precisely what contractual obligations (in the interest of third party or protecting a third party) has been breached. Hence, the debate on third party rights is strongly connected to the debate on obligations under EMC, Art. 1 and the question on one-sided or shared responsibility.

As to the option of excluding third party rights: In general, German contract law starts from the premise of an autonomy of the contracting parties to determine the contract (§§ 116, 145 BGB). Consequently, parties are also able to specifically agree on whether they want a third party to be part of the contract. In addition, § 328 BGB contains an explicit provision on the possibility of third-party rights and equally declares the stated intention of the parties to be relevant. Based on these rules, there would not be a problem with either clauses, i.e. excluding or creating third party rights. However, there are also positions in the academic debate suggesting that exclusion of third party rights would be problematic either because such would be contrary to the essential obligations under the law on unfair contract terms control (which is ensuring human rights respect and thus creating a position for rightsholders) or because of general contract law principles (in particular the prohibition of contradictory behaviour, venire contra factum proprium). There is not yet any case law on third-party rights for contractual clauses that relate to human rights respect and thus no indication on what the case law will suggest. Regardless of the agreement of the contract,

Additionally attention should be given to the implications under the German Supply Chain Act and CSDDD – these might argue for explicitly including third party rights: The German Supply Chain law can be read (there is legal debate on this and a lack of certainty, but the better arguments argue for an inclusion) and the CSDDD clearly needs to be read as including an obligation to effectively repair victims violated in their environmental or human rights by breaches of environmental or human rights due diligence. And both include obligations on providing potential and actual victims access to remedial mechanisms, which have to be accessible for employees and others at the supplier level and in the supply chain. Thus, if a violation is determined under the procedures under such mechanisms, repair for the victims would need to follow. This would include victims at the supplier level and in these cases likely mean that buyer and supplier will adequately share the costs according to contributions/capacity, likely with a special onus on the supplier since the violations will be likely to derive from his sphere and actions. In such a situation, this clause might be used by the supplier to deny participation in the remediation, as this would imply a benefit for a third party which is by this clauses explicitly included. Under German Civil Law, a lack of security of interpretation of terms and conditions can be used against the creator/user of the standard clause, which would likely be the buyer, Sec. 305 c (2). Therefore, this clause might hinder the effective collaboration between buyer and supplier and remedy and create the risk that the buyer will face the arising costs alone. Under the CSDDD, Article 29 creates a civil liability provision for third parties against obliged buyers anyway, making the exclusion of contractual third party rights futile as far as violations of Articles 10 and 11 are involved. An exclusion of this clause is therefore recommended and a clear allocation of responsibilities between buyer and supplier in the case of third-party victims to be preferred.

3. Italy

Unless specifically approved in writing by means of a double signature *(doppia sottoscrizione*), the general terms that establish, in favor of the party which unilaterally drafted them, limitations of liability, the right to withdraw from the contract or suspend its execution or provide for the other party the penalty of forfeiting rights, limitations on the right to oppose exceptions, restrictions on contractual freedom in dealings with third parties, tacit extension or renewal of the contract, arbitration clauses or exceptions to the jurisdiction of the judicial authority, are not valid under Italian law.

Under Italian law, a contract in favor of a third party grants such third party the right to receive performance from one or more of the contracting parties; such stipulation in favor of a third party is valid if the contracting party has an interest in it. The third party never becomes a party to the contract, although it is entitled to obtain performance.

Under Italian law, requiring Supplier to terminate an agreement or affiliation with a specific factory, terminate a subcontract or remove an employee or employees and/or other Representatives may potentially (if coupled with other undue influences on the Supplier's activities) fall within the scope of the Italian rules on the abuse of the economic dependence and/or "direction and coordination" activities (respectively, under article 9 of Law no. 192/1998 concerning the "Regulation of subcontracting in productive activities" and article 2497 and ss. of the Italian Civil Code) to the extent the exercise of such rights is excessive or not adequately justified by factual circumstances and material breaches by Supplier. Therefore, validity and implications of this provision will primarily depend on factual circumstances and on the way in which it is actually enforced. In case the rules on abuse of economic dependence are breached, the agreement through which the abuse of economic dependence is exercised is to be considered null and void and actions for injunctions and damages may be brought by the affected party. If, instead, the rules on 'direction and coordination' activities are triggered, leaving aside certain additional disclosure obligations, provided that certain additional requirements are met, Supplier might be held liable for the damages it has caused as a consequence of the abuse of the 'direction and coordination' activities.

4. Poland

Polish law does not include the principle of 'certainty of terms' sensu stricto. Nevertheless, terms which lack certainty can be difficult to enforce, found void or affect the validity of the entire contract under the principle of 'essentialia negoti' according to which essential terms of a contract must be sufficiently specified.

The provisions concerning the Corrective Action Plan and its inclusion as a binding part of the parties' contract, may pose challenges under the discussed principles because of the uncertainty of the obligations stemming thereof.

A requirement for the Supplier/Buyer to submit to an accessible procedure for resolution of disputes with the affected stakeholders and to conduct such disputes constructively, may be more operable.

A procedure in which the Corrective Action Plan will be drawn up by an impartial expert adjudicator, whose decision may be accepted by the Parties or not, or in which it will be set in a binding manner by an arbiter authorized to decide the matter ex equo et bono, could be considered.

In any case, elaboration of some objective parameters which should govern the drafting of the Corrective Action Plan and the distribution of the burdens connected with its implementation, is desirable, if the obligation to prepare and implement it is to be legally binding and not merely 'relational'.

5. Portugal

6. Spain

(d) Further to article 1255 of the Spanish Civil Code (the parties in a contract can agree on anything which is not contrary to law, morals or public order) a clause limiting or conditioning the termination rights of the Buyer is allowed. Notwithstanding this, it must be noticed that since 2016 the Spanish Supreme Court sustains that general terms and conditions of contracts ("*condiciones generals de la contratación*") amongst entrepreneurs (*"Empresarios"*) must be consistent with the principle of good faith, implying that in the future the Spanish courts could analyse the content of such clauses and modify it, altering the balance of rights and obligations amongst the contractual parties.

7. UK

The inclusion of this process around a remediation plan does not affect the parties' rights under English law, save that the Buyer will need to wait for the parties to go through these extra procedural steps around the remediation plan before terminating the Agreement for non-compliance. Although the concept of a remediation plan aligns with expectations under soft law standards and the approach seen in other contexts (e.g. project financings under the Equator Principles), difficulties are envisaged in practice with characterizing such plans as tools to restore affected stakeholders to the situation they would have been in had the adverse impact(s) not occurred given the complexity and nature of human rights issues. Section 2(a) may be especially challenging in this regard. An alternative could be to include a requirement that the Supplier obtain the Buyer's approval (or the approval of an appointed technical consultant) in preparation of the plan.

Under English law, the parties can choose who the third-party beneficiaries are. It should be noted that the list of intended third party beneficiaries is very broad compared to those one might ordinarily see (which is usually limited to specific parties who may have an interest in the transaction, such as group companies of one or more of the contracting parties), and that therefore the Buyer could be exposed to a proliferation of actions. In some cases, where the proposed third parties are very remote, it is not clear what the mechanics would be for them to enforce the contract in practice.

As an aside, it should be noted that a very unusual aspect of English law is that if third party beneficiaries are included, wording stating that the agreement can be amended/terminated without the consent of third-party beneficiaries should also be included, otherwise such consent is required for any such amendment/termination to be effective. An example of such wording is as follows: '*The parties agree that no consent from the persons referred to in [the third-party rights clause] is required for the parties to vary or rescind this Agreement (whether or not in a way that varies or extinguishes rights or benefits in favor of such third parties)*.'

8. Draft Common Frame of Reference (DCFR)

Section 2.1 is commensurate with Article III-401 DCFR. Articles III-3:202 and III-3:204 DCFR include a right to cure and govern the consequences of it. That said, Article III-3:203 allows termination without the right to cure under certain conditions.

Article IV.A-2:305 of the Draft Common Frame of Reference includes a provision on third party rights and will allow a providing for these rights.

Article 3

I. General commentary to Article 3

1. Introduction

This section provides for remedies in case of a default related to Human Rights and Environmental Due Diligence in accordance with Article 1 or a failure to establish or implement a Corrective Action Plan in accordance with Article 2. Obviously, other types of defaults are conceivable as well, but the presumption here is that they are dealt with elsewhere in the supply chain contract. It is well conceivable that the sections on remedies (3.2, 3.4 and 3.5) are to a certain extent also implemented elsewhere in the supply chain contract. However, one should note that Section 3.2 includes specific elements regarding defaults related to Human Rights and Environmental Due Diligence in accordance with Article 1 or a failure to establish or implement a Corrective Action Plan in accordance with Article 2, for example on responsible exit. Beyond this, section 3.3 is specific to this type of default and will not be provided for elsewhere in the supply chain contract either.

2. Section 3.1

(a) Articles 10(6) and 11(7) CSDDD, require an enhanced prevention action plan or an enhanced corrective action plan in case the prevention action plan or the corrective action plan did not work. This is also explained in Recital 50 of the CSDDD. This section clarifies that a refusal to or insufficient collaboration regarding a prevention/correction action plan can constitute a HREDD Default.

The notice mentioned in this section should include of the following matters: (i) that the party has formed the view that a Default has occurred and the party's reasons for that view, (ii) reasonable details of the breach; (iii) that the defaulting party must prepare and implement measures to remedy the default.

Such measures may be accompanied by a plan which sets out:

(i) the steps that the defaulting party proposes to take to cure the breach;

(ii) a timeline for the completion of the measures, to be agreed between the parties;

(iii) quantitative and/or qualitative indicators for determining when the measures are completed.

Under the national contract laws of some member States, it is allowed to invoke the consequences of a breach before it has occurred under specific conditions, for example when the Supplier has announced it will not comply with a specific element of the Agreement, for example the establishment and implementation of a remediation plan. In these systems the consequences of sections 3.1-3.5 may also be invoked to the situation in which a breach is imminent. This may be clarified in these sections.

In some instances, Buyer has required Supplier to source from specific suppliers. If the default occurs at this supplier level, Buyer should see to it that this default is cured. If this is not achieved within the set timeframe or is impossible within that timeframe, Supplier may require Buyer to consent to sourcing from another supplier. Obviously, this may also be a reason for Buyer to terminate the agreement with this designated supplier (under the conditions set forth in Article 2(d) on responsible

exit), but this would be the sole responsibility and choice of Buyer and not of Supplier. Therefore, it is not logical if Supplier could require Buyer to terminate this agreement.

(b) Buyer has the obligation to collaborate with and support the Supplier to ensure remedy for the affected persons or individual as Articles 11(3)(h) and 12 CSDDD require and necessary investments to prevent future adverse impacts as Article 11(4) CSDDD demands. It may be argued the collaboration of Buyer in the remediation of Adverse Impacts would deprive the Buyer from his statutory right to claim damages from the Supplier in case of an Adverse Impact, but this would not be the case. The Buyer has contributed to the Adverse Impact and has an own obligation to compensate the affected individuals. The circumstance these damages are partially paid from the damages the Supplier may have to pay to Buyer does not alter this. That said, such collaboration with Supplier should not be considered to be a waiver of Buyer's rights under Article 3.

3. Section 3.2

Seeking for contractual assurances is acknowledged as a means of preventing or addressing environmental and human rights abuse by Articles 10(2)(b) and 11(3)(c) and 11(5) of the CSDDD. Pursuant to Article 11(6) CSDDD these contractual assurances need to be fair, reasonable and non-discriminatory if a small or medium sized Supplier is involved.

It is also important to meaningfully consult affected individuals or organizations or their representatives when exercising these remedies.[47] This is also required by Article 13 CSDDD.

Some supply contracts will call for payment by letter of credit, which will complicate the right to suspend payment. When a documentary credit is involved, the supply contract and letter of credit should require presentation of a certificate of compliance with the obligations under the Agreement. In any case, the certificate should be required to be dated within a reasonably short time of the draw. Many banks probably will not object to the requirement of an additional certificate as certificates (e.g., by SGS) are commonplace in such transactions, and environmental certificates are similar to (and in some cases may be the same as) a certificate of compliance with the Agreement. While some banks may resist the requirement of such a certificate because of fear of injunction actions and the concomitant extension of the credit risk if the injunction is ultimately denied, most banks seem unlikely to be concerned by the requirement of one more certificate, and any additional credit risk from an injunction may be mitigated by a bond or other credit support by the civil procedure laws or rules of certain jurisdictions requiring posting of a bond, or by collateralization or bonding provisions in the reimbursement agreement itself. Still, despite all of these efforts, suspension of payment may be impossible in cross-border documentary credit transactions because frequently a foreign bank will have honored before the injunction can issue.

(c) This section is important as goods tainted by human rights violations, for example connected to forced labor, may not pass without objection in trade.[48] This is especially relevant where seizure of goods by customs is impending or as actually happened. This may be the consequence if goods are

[47] Article 13 and Recitals 40 and 65 CSDDD.

[48] See for example Article 3 of the proposed Regulation of the European Parliament and the Council on prohibiting products made with forced labor on the Union Market, Com(2022) 453 final, accessible at https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:52022PC0453&from=EN.

produced with forced labor according to Articles 6, 17 and 19 of the previously mentioned Draft Regulation on Forced Labor.

Nonconforming Goods are presumably defined elsewhere in the supply chain contract, for example, with respect to conformity to product specifications. This section clarifies that goods that conform to product specifications may nevertheless be rejected in the circumstances specified in the text. Note that this requires causing of or contribution to an Adverse Impact by Supplier. This is not necessarily the case if this impact occurs further down the supply chain. In such instances it may be conceivable that Supplier has undertaken proper due diligence as defined in Article 1.1 but the Adverse Impact nevertheless occurs. Then the remedy implemented in Article 3.2(c) will not be available to the Buyer. This may be relevant because the risk of seizure of goods tainted by human rights abuse. If the goods cannot be released into the Union market or otherwise sold where and when Buyer intended, Buyer must have the right to reject the Goods as Nonconforming Goods. Similarly, if Buyer cannot sell the goods in the ordinary course of business, it should have the right to reject the Goods unless Buyer's own actions caused or contributed to the problem in a material way.

If the Supplier is a small or medium sized enterprise, Article 11(6) of the CSDDD requires that the contractual assurances obtained shall be fair, reasonable and non-discriminatory. It should be considered whether rejection of goods will be considered as such in all circumstances.

Articles 38–40 of the CISG require that Buyer examine the goods or cause them to be examined within as short a period as is practicable. Buyer loses the right to rely on a lack of conformity if Buyer does not give Supplier notice within a reasonable time after Buyer discovers or ought to have discovered a defect and, at the latest, within two years of the date of delivery (or other contractual period) unless Supplier knew or could not have been unaware of the defect. Contract law of most member states include such limitations and usually mention a reasonable time after the discovery of the defect.

The terms 'Nonconforming Goods' are assumed to be defined earlier in the supply chain agreement. Nevertheless, Nonconforming Goods are defined specifically for purposes related to human rights policies in Section 3.2(c).

4. Section 3.3

(a) It is important that neither Buyer nor Supplier benefit from an Adverse Impact. For example, if Buyer orders additional goods with a very short lead time which foreseeably causes excessive overtime being made by Supplier's workers, this may result in a profit for the Buyer being able to sell more goods with a good margin. However, when claiming damages from Supplier because of the noncompliance with obligation to address this Adverse Impact, this profit should be taken into account, especially in connection with the compensation which should be paid to Supplier's workers and in which the Buyer has a responsibility because of its contribution to the Adverse Impact.

(b) In connection with damages it is important to note that Articles 11(3)(h) and 12 CSDDD require the compensation of affected individuals or affected communities. Buyer should see to it this is actually implemented and should even pay (part of) these damages in cases in which the Buyer has contributed to these adverse impacts as envisaged in Section 3.4(b). The compensation of affected persons/communities should prevail over the damages the Buyer may claim from the Supplier and, thus, as long as the Supplier avails over insufficient funds to compensate the damages of both the

affected persons/communities and of the Buyer, the Buyer should accept the affected persons/communities being compensated first. This section includes such a provision in 3.3(b).

Here third-party beneficiary rights may be implemented too. See the practical guidance to Article 2(a) for an example of a clause granting these rights.

5. Section 3.4

This section governs indemnification and comparative fault. For example, if Supplier agrees to a change order requested by Buyer and the parties should know that Supplier will be unable to perform without the occurrence of Adverse Impacts, indemnification to Buyer must be reduced to the extent, pro rata, that Buyer caused or contributed to the harm. This clause sets up a mechanism akin to a comparative fault regime.

6. Section 3.5

As is also elaborated in connection with Section 2(d), human rights remediation should not build on termination as current contractual mechanisms often do. Termination often worsens the human rights or environmental situation and is, generally speaking, in no one's interest.[49] The buyer does not want to suffer the disruption and incur the delay or switching costs to transfer its business to new suppliers. The supplier certainly does not want to lose business. And except in the most extreme circumstances, the workers do not want to lose their jobs and their livelihood. Therefore, this section requires remediating the problem commensurate with section 2(d) by taking measures to stop and correct the harm and to address any grievances. A right to cure is also essential to the ability of a party to avoid the human rights harms to workers and others that may result from the termination by the other party of the Agreement.

This is explicitly acknowledged Article 11(7) CSDDD which sets forth that prior to temporarily suspending or terminating the business relationship, the company shall assess whether the adverse impacts of doing so can be reasonably expected to be manifestly more severe than the adverse impact that could not be prevented or adequately mitigated. Should that be the case, the company shall not be required to suspend or to terminate the business relationship, and shall be in a position to report to the competent supervisory authority about the duly justified reasons of such decision.

Articles 10(6), 11(7) and 13 CSDDD and Recitals 40, 50, 57 and 65 confirm that companies should continuously engage with their business relations and disengagement is a measure of last resort. Recitals 50 and 57 of the CSDDD also allow prioritizing engagement with business relationships in value chains instead of termination as a last-resort action after unsuccessfully attempting preventing and mitigating adverse impacts. If the adverse impact cannot be brought to an end. Article 11(7) CSDDD and Recitals 50 and 57 also refer to the obligation to, as far as allowed by the applicable law, suspend commercial relationships if it is expected to be successful on the short-term or terminate if the potential impact is severe. In such instances Articles 10(6) and 11(7) CSDDD also set forth that the buyer should refrain from entering into new or existing relationships with the supplier which was involved in the impact. Thus, this section is commensurate with Articles 10(6) and 11(7) CSDDD as these only allow termination if other due diligence measures by Buyer are not effective.

[49] See also Recitals 50 and 57 CSDDD.

Furthermore, it only allows for termination of the Agreement if severe Adverse Impacts have not been cured or adequately mitigated in the cure period or cannot be cured, the Buyer has not contributed to the Adverse Impact and the Supplier has caused or contributed to the impact. Termination is not allowed if, for example, the Adverse Impact is observed further down the supply chain and is not caused or contributed to by the Supplier either. In such instances parties should negotiate in good faith to find a solution for the Adverse Impact.

As is elaborated in Article 2(d) termination should result in a responsible exit. This section may not be understood as to support a 'hit and run' strategy, meaning immediate termination by Buyer if an Adverse Impact is identified and neglecting the Buyers responsibilities regarding remediation for those individuals affected. In order to strengthen this obligation of Buyer one may introduce a rebuttable presumption that termination will not be responsible if Buyer has contributed to the Adverse Impact. More generally speaking in seeking certain of the remedies provided for (e.g. termination of agreements, removal of employees, suspending payments), it should be noted that it will be important for the enforcing party to consider any potential adverse human rights impacts of such actions which could compound existing adverse impacts (as contemplated section 2(d)).

Beyond this, the EU directive on unfair trade practices in agricultural supply chains[50] does not allow short-term termination of agreements regarding fungible goods, although member states may allow an exemption if these goods can reasonably be sold elsewhere.[51] Furthermore, Article 3(1)(h) Unfair Trade Practices Directive in agricultural supply chains prohibits retaliation against the supplier, for example, by reducing or cancelling orders. Therefore, if termination is considered to be retaliation it is not allowed under this directive.

One should note that several European legal systems allow for termination for breach without notice under specific conditions, for example in case of irreversible damage.

[50] Directive EU 2019/633.

[51] Article 3 section 1 and Recitals 17 and 20 of the directive.

II. Practical guidance to Article 3

1. Section 3.4

The definition of a contribution of Buyer to environmental impact may have to different from direct human rights impact. Therefore, it may be helpful to further define contribution to environmental impact.

2. Section 3.5

The former Bangladesh Accord (currently International Accord) provides some additional guidance on responsible exit.[52] It includes three stages. First a letter should be sent to the supplier management to inform it, it is in breach of the remediation plan and to give a specified number of days to bring about specified improvements, if these are implemented no further steps are necessary. If not, the management of all the brands sourcing from the factory send a warning letter to the supplier, stating that if the steps specified in the remediation plan are not taken within a specified number of days these brands are legally required to terminate the relationship. At this point the Accord Secretariat, the supplier and the brands to explain how disengagement should proceed, if necessary, and to determine whether additional financial commitment from the brands is required. The third step is responsible disengagement if the requirements of the remediation plan are not met within the specified time. This implies collective disengagement by all Accord brands. However, the brands are still responsible for compensating workers for termination of work resulting from disengagement, but no longer for other cost. This implies, for example, that the disengaging brands are expected to temporarily pay workers' salaries, and the brands have to make reasonable efforts to find alternative employment for the workers as the working environment is unsafe in such cases. This is especially important for union leaders who may have pointed at the issue and may be blacklisted. Blacklisting results in difficulty in finding future work. In such cases the Accord may also intervene. The supplier then remains blacklisted for 24 months and may reapply after that. That said, in case of acute fire or building danger the escalation protocol may be skipped and a buyer may immediately move to disengagement. This is an interesting example as it uses collective leverage of buyers sourcing from a specific facility to increase the credibility and eloquence of the threat of disengagement, which is a more powerful instrument than such a threat expressed by a single buyer. This is not a feature which as such can be included in model supply chain contracts, but it can be part of multi-stakeholder initiatives and collaboration between buyers to increase leverage. It should also be noted that disengagement does not terminate responsibilities of the buyer towards workers, especially regarding their compensation and, if applicable, reasonable efforts to find alternative employment for them. Beyond this, a model contract may include a provision stipulating that the buyer will not reengage with the supplier during a specified period of time, for example, 24 months. This also increases the threat of disengagement. It is to be expected that European multi-stakeholder initiatives, such as the Dutch International Responsible Conduct Agreements and the Fair Wear Foundation, may consider and implement this disengagement approach as a best practice.

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[52] The Bangladesh Accord 'escalation protocol' for responsible engagement and disengagement. See on this OECD Watch, Legislating due diligence: Respecting rights or ticking boxes?, p. 26, accessible at https://www.somo.nl/respecting-rights-or-ticking-boxes/.

III. Member State specific comments to Article 3, UK and DCFR

1. France

The article seems commensurate with Article 1231 of the French Civil Code.

Section 3.3(c): Article 1218 Code Civil includes a reasonable period after discovery of the defect in which a contractual party must inform the other party of the defect.

2. Germany

In principle, due to the principle of party autonomy, parties may agree on the terms of their contract including on the remedies. Hence, agreements as to the remedies are possible to the extent that they do not disproportionately disadvantage one of the parties. The structure of remedies under German civil law is organized to prioritize specific performance (s. 439 German Civil Code) with other typical sales law remedies (recission, price reduction damages) being subject to additional conditions. Against this background, some of the remedies could be interpreted as being subject to additional requirement. This applies to withdrawal from the contract, which is subject to the condition that the defaulting party to the contract declares not to perform or the non-defaulting party having given a deadline for performance of the contract that has passed. In a sales contract, the non-defaulting/innocent party can, instead of withdrawing from the contract, claim price reduction (§ 441 BGB).

When it comes to damages, German law requires fault or intention to apply the remedies provided for in Article 5 (§ 280 (1) 2).

Articles 3.1 and 3.5 comply with German law's general prioritization of performance and the right to cure over termination and rescission. It is to be noted, however, that considerable improvements that are achieved or can be expected are enough for an exit not to be required under LkSG, see Sec. 7 (3) No. 2 with Sec. 7 (1), s.1 - a "minimization" of a violation is also considered a remediation. Exceptions from the requirement to set a notice period exist (among others) in case Supplier refuses performance seriously and definitively, and if special circumstances, having weighed the interests of both parties against each other, justify immediate termination. German law however only allows for termination within a reasonable time period after gaining knowledge of the reasons for termination (section 314 § 3 German Civil Code). This provision intends to force the parties to create clear relations as early as possible. Under German law on general terms and conditions, clauses providing for rights to terminate or rescind in case of any violation are ineffective.

The model clauses provide for several termination rights, amongst others in this article and in Articles 2 and 3.5. Implementing such a right in different places creates a risk of the contract not being clear, and thus, of being void under German law governing general terms and conditions.

3. Italy

Section 3.1: It is important to note that according to Italian law, the terms 'fault' and 'intentionally' should be replaced with the terms negligence (*colpa*) and wilful misconduct (*dolo*), referred to in the applicable Italian contractual liability law.

Section 3.2: Under Italian law compensation for damages for non-performance or delay shall include the damages (*danno emergente*) suffered by the creditor as well as the loss of profit (*lucro cessante*), insofar as they are an immediate and direct consequence of the breach.
Beyond this, if the non-performance or delay is not due to the debtor's willful misconduct, the compensation shall be limited to the damage that could have been foreseen at the time when the obligation arose. Finally, in the event of breach of an agreement, not only pecuniary damages but also non-pecuniary damages may be compensated.
Pursuant to Section 1229 of the Italian Civil Code, any *ex ante* limitation of the liability of a party for damages caused by intentional misconduct (*dolo*) or gross negligence (*colpa grave*) is null and void. This might potentially be in contrast, for instance, with the principle that remediation should have priority over the payment of damages in case of intentional or grossly negligent breach of contract that also resulted in an Adverse Impact.

4. Poland

Limits on interpretation/modification by conduct will be valid and enforceable as long as they are not used to endorse an unconscionable, inconsistent conduct.

Section 3.1: this section provides for no informal modification in the matters concerned. This section may well serve as 'lex specialis' to any modification rules in the supply chain agreement, which may be more liberal and therefore inappropriate here.

Section 3.2(c): Under Polish law rejection of non-conforming goods is tantamount to avoidance of the contract. The contract is then considered void *ex tunc* and performances must be returned. However, it is allowed under the principle of freedom of contracts to negotiate the consequences of the goods being non-conforming in the way stipulated in the model clauses (provided that it does not provide the Buyer with the opportunity to deny payment to the Supplier at the Buyer's undue discretion). That said, It would probably be more suitable under Polish law to draft the currently envisaged remedies concerning the non-conforming goods as part of the agreed 'mitigation of loss procedure' – which means to leave it at the Buyer's discretion whether to reject the goods in the strict sense and return them for reimbursement of the price (which right should be limited by a fixed reasonable deadline) or to keep them but dispose of them appropriately in an effort to mitigate the loss caused by their non-conformity, and to claim appropriate damages from the Supplier afterwards.

5. Portugal

Section 3.2: In Portugal courts are entitled to reduce the liquidated damages provision if it is deemed to be unreasonable in light of the damages and losses effectively evidenced before the court.

Section 3.3: The broadness of these provisions may give rise to serious unintended consequences, notably as a reimbursement or compensation would need to be awarded by reference to specific losses and damages evidenced by the non-breaching party. Thus, the commitment to have those amounts be redirected to remediation processes may leave the non-breaching party in a worse position and, concomitantly, work as an unlawful limitation to the right of a party to access legal remedies available to it or to terminate the agreement by breach.

6. Spain

Section 3.2: according to article 1.102 of the Spanish Civil Code, any limitation of liability (either as regards the amount or the capacity to claim it) is not enforceable when the party who claims the limitation acted with wilful intent ("dolo").

Under Spanish law, absent wilful intent ("dolo") the parties can agree on a specific amount to be claimed in case of breach of a specific clause or undertaking provided that such amount is not disproportionate (in which case the Judge, under certain circumstances, can moderate the amount). In addition to this, the parties shall bear in mind that the Spanish Civil Code only refers explicitly to actual damages suffered as a consequence of a breach of contract ("daño emergente") and loss of profit ("lucro cesante") and that the concepts of consequential and indirect damages, if used, are ambiguous and open to interpretation, without the Spanish case law having clarified their content.

According to article 1.102 of the Spanish Civil Code, any limitation of liability (either as regards the amount or the capacity to claim it) is not enforceable when the party who claims the limitation acted with wilful intent ("*dolo*"). Therefore, in the event of wilful misconduct of the Supplier, a judge may consider that the Client is not obliged to follow the order of remedies established in the agreement (i.e., Corrective Action Plan) and shall be entitled to directly claim the losses suffered.

Regarding Section 3.2(b), it must be taken into account that, under the Spanish Procedural Act, if the Buyer files a request for interim measures, the Buyer will be obliged to file a claim before the Spanish Courts within the following month after the adoption of the interim measures.

Section 3.2(c): Pursuant to article 1255 of the Spanish Civil Code, which establishes freedom of contract, article 3 would be enforceable under Spanish law, although it would be advisable that it is clarified in more detail which Adverse Impacts would turn the Goods into Nonconforming Goods.

7. UK

Section 3.1: this section provides for an obligation on the Buyer, Supplier and Representatives to engage in human rights due diligence (in accordance with sections 1.1-1.3). It may well prove challenging to obtain an order requiring a party to comply with certain positive contractual obligations of this nature. That said, Article 3.2(c) also provides for certain express rights to reject nonconforming goods; and Article 3.5 to terminate the contract in the event of certain breaches. These contractual remedies mean that the issues identified with the other remedies may be less important.

Section 3.2: The Buyer's proposed remedies include obtaining an injunction with respect to Supplier's noncompliance; and requiring a Supplier to terminate an agreement or affiliation with a specific factory, to terminate a subcontract or to remove employees/other representatives. [53] Under UK law it is recommended to amend the drafting of clause 3.2 to refer to '*specific performance*[54] *and/or an injunction';* and to refer to the parties' agreement that '*damages would not be an adequate remedy'* for breach.

However, it is important to note that a Buyer may face challenges in seeking to enforce these rights/remedies. This is because injunctions and specific performance are discretionary remedies that are not available as of right. For instance, these remedies would not typically be granted if the

[53] This may raise labor law issues which are not further considered here.

[54] Specific performance is an order compelling a party to perform positive contractual obligations.

relevant terms are too uncertain/imprecise for a clear order to be made; where ongoing supervision/oversight would be required; and/or where damages would be an adequate remedy (amongst other considerations).

The proposed drafting tweaks above would reduce the likelihood of a court/tribunal considering that damages are an adequate remedy. However, there may well still be difficulties in obtaining an order requiring a Supplier to comply with certain obligations (e.g. in connection with human rights due diligence/compliance or the preparation and implementation of a Remediation Plan) because of the issues flagged above.

8. Draft Common Frame of Reference (DCFR)

The remedies envisaged in Section 3.2 are commensurate with the DCFR, especially with Articles III-3:302, Article III-3:502 and Article III-3:701.

Section 3.2 relates to Article III-3:505 which allows the Buyer to ask for adequate assurances and if not provided grants the right to terminate. However, as explained hereinabove such termination should be responsible.

Section 3.2(c): Article III-3:103 DCFR includes a notice as required by this section. A failure to notify the other party of a defect within reasonable time may also restrict remedies under Article III-3:107 DCFR. Article IV.A-2:308 DCFR includes a more specific rule regarding sales contracts.

Section 3.4: Article III-3:704 and III-3:705 also explicitly acknowledge the right to damages of the Buyer may be reduced if Buyer has contributed to these damages or could have taken reasonable steps to reduce the loss of the Supplier.

Section 3.5: this section may be suspect under Article III-3:105(2) if non-termination would violate good faith and fair dealing. However, it is expected that this would rarely happen. It may also be contrary to Article III-3:502 if the non-performance is fundamental, which may be the case regarding human rights violations. However, one may argue this section is connected with providing the supplier a period of time to cure the non-performance which is allowed under Article III-3:202. Termination is also envisaged in Article III-3:502 if a fundamental breach has occurred.

Article 3.5 restricts termination, in line with Articles 10(6) and 11(7) CSDDD, further than the DCFR envisages.

Article 4

I. General commentary to Article 4

Section 4.1: This article allows Buyer to audit the Supplier's premises and labor practices. However, Suppliers are generally reluctant to accept control over their activities.[55] This Article clarifies control by Buyer may not exceed the control needed to comply with Articles 1 and 2. Beyond this, more extensive control may also be contrary to contract law in several countries.[56] Furthermore, a supplier may refuse to collaborate if it can provide equivalent information (e.g. an audit undertaken by another buyer) or if it collaborates in an effective mechanism addressing HREDD obligations (such as some multi-stakeholder certification systems).

One should realize that audits are just a snapshot in time and can, therefore, not be the only means to assess whether Supplier has implemented proper human rights and environmental due diligence.[57] Thus, audits are not a panacea to check Supplier compliance with Articles 1 and 2. Usually, they are a snapshot in time and Suppliers are often quite able to hide non-compliance. Therefore, other instruments like information from grievance mechanisms, (independent) stakeholder consultations and other means of acquiring information are as important.

Section 4.4: This section is required by Articles 10(5) and 11(6) CSDDD as far as Supplier is an SME. If not, parties are free to choose whether Supplier or Buyer pays for the audits.

II. Practical guidance to Article 4

III. Member State specific comments to Article 4, UK and DCFR

1. France

1. Germany

3. Italy

4. Poland

[55] See e.g. BAFA Guidance ("Zusammenarbeit in der Lieferkette zwischen verpflichteten Unternehmen und ihren Zulieferern - Die wichtigsten Fragen und Antworten für KMU", 1ed June 2023), p. 21.
[56] See BAFA Guidance ("Zusammenarbeit in der Lieferkette zwischen verpflichteten Unternehmen und ihren Zulieferern - Die wichtigsten Fragen und Antworten für KMU", 1ed June 2023), p. 21.
[57] Cf. BAFA Guidance ("Zusammenarbeit in der Lieferkette zwischen verpflichteten Unternehmen und ihren Zulieferern - Die wichtigsten Fragen und Antworten für KMU", 1ed June 2023), p. 16.

5. Portugal

6. Spain

Under article 42 of the Spanish Workers' Statute, companies who subcontract their own activity must obtain a certificate stating that the relevant supplier has no pending debts with the Social Security. Otherwise, the client will be jointly and severally liable with the supplier for the latter's obligations with the Social Security during the term of the agreement and three years thereafter.

Under Spanish law the exclusions associated with labour matters are lawful and advisable. However, although the terms of the supply agreement can be considered as an indication, for the assessment on whether there is a labour relationship between the Supplier's employees and the Client, the courts will consider the actual facts of the relationship irrespective of the provisions included in the agreement.

7. UK

8. Draft Common Frame of Reference (DCFR)

Article 5

I. General commentary to Article 5

1. Introduction

This Article presumes Buyer and Supplier have implemented a dispute resolution clause in the sales agreement to resolve disputes arising out of the agreement. Therefore, it is not necessary to implement a specific clause on this here. However, jurisdictional issues may emerge in connection with this clause in the sales agreement and the clause in Article 5. One should bear in mind that these arbitral clauses govern disputes between different parties. The clause in the sales agreement governs disputes between buyer and supplier regarding all disputes emerging out of the sales agreement, which may include disputes over management and consequences of environmental and human rights related matters between buyer and seller. This may include disputes relating to the contribution to an impact of buyer or supplier. Article 5 governs other types of disputes between other parties. It governs disputes between buyer and supplier on the one hand and rights holders on the other regarding remediation of a potential or actual adverse impact. Therefore, the arbitration/litigation referred to in Article 5 only governs the remediation towards rights holders. How the consequences of this remediation should be born and/or distributed between buyer and supplier is not governed by this clause. This should be addressed in the arbitration between buyer and supplier as implemented in the sales contract.

2. Sections 5.1 and 5.2

These sections aim to resolve disputes between one or both parties and stakeholders. However, it is questionable whether third beneficiary rights regarding dispute resolution which would be extended from the outset of the agreement and regardless of which stakeholders in a supply chain would be affected by an at that moment in time undefined impact, would meet the requirements of legal certainty, as it is unclear at the conclusion of this agreement whether such a dispute may arise, regarding which type of human rights issue and with whom. This issue may be addressed by agreeing in the contract that if affected rights holders claim a (severe) human rights issue has emerged and a Remediation Plan as referred to in Article 2(a) is prepared, this should include a dispute resolution mechanism. The dialogue phase as referred to in section 5.1 is more common to date, as Buyer and/or Supplier often establish such dialogue-based mechanisms (operational level grievance mechanisms) and this is also envisaged in this agreement in Article 1.4. At the time such human rights impact has occurred it will be clear(er) which stakeholders are involved and which human rights issue is concerned. Thus, the first step of the dispute resolution mechanism which is part of the remediation plan should be a dialogue aiming to solve the issue and including access for relevant stakeholders. If the dialogue does not bring about a solution, the issue is escalated to arbitration. This also clearly delineates the third-party beneficiaries that are involved in the arbitration. Obviously, the question who could be considered to be an affected individual, community or entity is shifted to the dialogue phase. Although these may be lengthy processes, facilitators in such dialogues between business and affected individuals or communities have by and large been able to delineate the relevant group. If certain issues are not arbitrable, the Article provides for litigation in a national court.

3. Section 5.3

This section aims to prevent retaliation by the parties against those participating in the dispute resolution process. This is a frequently emerging issue in dispute resolution.

II. Practical commentary to Article 5

III. Member State specific comments to Article 5, UK and DCFR

1. France

Sections 5.1 and 5.2: It is important to bear in mind Articles 54, 58, 131(1), 1532 and 1565 of the Code of Civil Procedure (CCP), which impose specific requirements on arbitration, mediation and litigation. Furthermore, if a specific human rights or environmental issue is considered to be of an administrative nature Articles L-R. 213 ff. of Décret n° 2017-566 of 18 April 2017 include rules on such administrative mediations.[58] Furthermore, not all human rights and workers rights issues are amenable to mediation or arbitration under French law. Beyond this, the distinction and boundaries between mediation, arbitration and litigation may not be clear and should be clarified.

Section 5.2: Arbitration is governed by Articles 1474 ff and 2061 CCP.

2. Germany

Section 5.2: German civil procedure law has specific rules on arbitration agreements in §§ 1025 ZPO et. seq. Pursuant to Section 1030 of the Code of Civil Procedure, property disputes may be the subject of an arbitration agreement. Non-property disputes can be settled in an arbitration agreement insofar as the parties are entitled to reach a settlement on the subject of the dispute. Thus, e.g. matrimonial and child matters are not arbitrable. Arbitrability is affirmed for disputes about violations of general rights of personality ("Persönlichkeitsrechte"). There is no clear, definitive list in Germany of the matters that cannot be submitted to arbitration.

A special feature of German law is § 1027 ZPO, according to which a violation of a non-mandatory provision or a violation of a procedural requirement agreed upon by the parties must be noted immediately in the arbitral proceedings. Otherwise, this procedural violation is precluded.

Arbitral tribunal may order interim or protective measures at the request of a party. It should be noted that according to § 1033 ZPO, an arbitration agreement does not preclude a court from ordering a provisional or protective measure in respect of the subject matter of the dispute. Parties cannot derogate from this rule. Courts can enforce interim or protective measures by an arbitral tribunal, unless such a measure is already filed with a court under § 1033 ZPO.

[58] Furthermore Articles 127 ff Code Civil also include rules on mediation.

Additionally, under requirements of stakeholder engagement under Sec. 4 (4) of the German Supply Chain law and under the CSDDD, it is advisable to include requirements on the participation of rights holders when remedial measures for adverse human rights impacts are agreed upon in arbitration.

3. Italy

Section 5.2: Under Italian law, all documents filed by the parties in the context of litigation proceedings are confidential. However, *(i)* decision of Italian Courts (as well as of European Courts) – usually duly redacted – may be published *ex officio* on the judicial repositories in order to be consulted by the public, depending on their impact and relevance on the shaping of the legal system and *(ii)* the rendering of the final discussion is usually public, unless the Judge orders that it shall be held privately due to security issues, public order or common decency ("*buon costume*").
Under Italian law, in order to be valid and enforceable, the choice of forum and the arbitral clause shall be specifically approved by the parties pursuant to articles 1341 and 1342 of the Italian Civil Code ('*doppia sottoscrizione*') as vexatious clauses ('*clausole vessatorie'*) to the extent the agreement is drafted unilaterally by one of the parties without actual negotiation.
An arbitration clause is valid, insofar as the parties do not dispose of their own human rights, but submit to arbitration a contractual dispute that originates from a breach of human rights of a third party, which – in turn – affected their contractual and commercial relation. Indeed, pursuant to article 806 of the Italian Code of Civil Procedure, non-disposable rights ('*diritti indisponibii'*; *e.g.*, health, physical integrity, freedom etc.) may not be referred to arbitration; as just explained, this restriction would not be applicable as long as the non-disposable rights affected are those of the parties to the agreement.
The inclusion of a specific choice-of-law and forum clause may potentially lead to that clause being considered as having a scope limited only to the human rights standards and ethical practices agreed upon therein.

4. Poland

Sections 5.1 and 5.2: Under Polish law all cases which can be settled privately by the Parties are arbitrable. This includes private law aspects of human rights violations. Importantly, employment disputes can only be referred to arbitration in a compromise (an agreement to arbitrate concluded only after the dispute arose). Waiver of 'any right to commence any action in or before any court or governmental authority, except as expressly provided in this Article 5' will be ineffective in as far as it would prevent access to public law remedies. The right to challenge an arbitral award issued in proceedings seated in Poland through setting aside proceedings cannot be waived. Nor can the right to oppose enforcement of a foreign arbitral award in Poland. However, in both cases the grounds for challenging the arbitral award are very limited. It may be advisable to include a clause obliging the parties to include identical dispute resolution clauses in upstream and downstream contracts to render a joinder of parties and cases possible/easier.

If litigation is initiated in disregard of a valid mediation agreement, the court refers the parties to mediation (but the proceedings are validly issued). As far as arbitration is concerned, failure to exhaust pre-arbitral steps is normally not considered an obstacle to initiate arbitral proceedings in Poland, although the issue is not clear and decisions vary from mere cost sanctions to rejecting a claim not preceded by the exhaustion of pre-arbitral steps 'without prejudice'. The wording

proposed in this section suggests that a dispute is not 'arbitrable' before pre-arbitral stages are exhausted and a claim submitted prematurely should be rejected by the arbitrators 'without prejudice'. This will not necessarily be followed by the arbitrators, who may choose to proceed with the claim regardless and only sanction the claimant with costs, if they consider his decision to initiate arbitration without exhausting pre-arbitral steps unconstructive.

Consent judgments are not envisaged in Polish court proceeding (but are often issued in arbitration). In court proceeding a settlement can be concluded before the court, included in the court record and enforced. However, it is not a court judgment for the purposes of enforcement abroad.

5. Portugal

6. Spain

Section 5.1: According to section 2 of Spanish Law on Civil and Mercantile Mediation, employment matters cannot be subjected to mediation, nor any matter involving criminal law or mediation with public administrations.

Section 5.2: Submission to arbitration is lawful under Spanish law and the arbitration award is deemed to be final unless, according to section 41 of the Spanish Arbitration Law, there have been defects in the arbitration proceedings notifications, the arbitrators have decided on matters beyond their power to decide, the arbitration proceedings are inconsistent with what the parties have agreed in the contract clause establishing the arbitration (unless such agreement is contrary to Law), the arbitrators have decided on matters which cannot be subject to arbitration or the award is against Spanish public order, in which case the arbitration procedure and the arbitration award can be challenged before the Spanish Courts.

Other than the above, the parties can agree on submitting their disputes to good faith negotiations, mediation and/or arbitration.

7. UK

The proposed dispute resolution clauses will need to be considered in the context of any dispute resolution provisions in the main sales agreement. The clauses appear to contemplate that the parties may include separate litigation/arbitration provisions in the main sales agreement; and the clauses set forth herein (see, e.g., section 5.2). In principle, it is possible to have multiple dispute resolution mechanisms. However, this could give rise to significant difficulties and the risk of parallel proceedings (for instance, where a dispute relates to the main provisions of the sales contract and the clauses set forth herein), so would need to be considered carefully in any given case.

8. Draft Common Frame of Reference (DCFR)