

Supply Chain Due Diligence – Legal and Compliance

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Environmental, Social and Governance (ESG)



ESG topic – history

2004: “Who Cares Wins – Connecting Financial Markets to a Changing World”

20 financial institutions invited by United Nations Secretary-General Kofi Annan draw up a report for the financial markets:



The institutions endorsing this report are convinced that in a more globalised, interconnected and competitive world the way that environmental, social and corporate governance issues are managed is part of companies’ overall management quality needed to compete successfully. Companies that perform better with regard to these issues can increase shareholder value by, for example, properly managing risks, anticipating regulatory action or accessing new markets, while at the same time contributing to the sustainable development of the societies in which they operate. Moreover, these issues can have a strong impact on reputation and brands, an increasingly important part of company value.

2005: The United Nations Environment Programme Finance Initiative commissioned a new, this time legal, report on the topic ESG. According to the questioned international law firm, it was permissible for investment companies to integrate ESG issues into investment analysis, and it could even be viewed as a part of their fiduciary duty.

ESG topic – nowadays

- ESG is a global trend, all continents / industries are involved
- European Union can be considered as the leader (**most intense regulation & most advanced market** for ESG investments)
- Increasing, dynamic and very complex regulation
- Challenging terms for major actions

Reality vs Criticism:

- What is it (is it a bad thing) and why is it important?
- Do we want to live in a better world?
- If yes, do we need to wait or act now?
- Is there a place or even time for criticism or should we rather focus our power and efforts towards actions?

ESG is about achieving Sustainability: HOW



CSRD – what to report

CSRD is a European Union (EU) directive, which entered into force in January 2023, aimed at expanding and harmonizing SR requirements for companies operating within the EU. It builds upon the existing Non-Financial Reporting Directive (“**NFRD**”) and seeks to enhance the transparency and comparability of sustainability information provided by companies. The key features of CSRD include:

- **Scope:** CSRD is expected to apply to 50,000+ large and publicly traded companies, including listed companies, banks, insurance companies, and other entities deemed significant for public interest.
- **Reporting Standards:** CSRD proposes the use of the European Sustainability Reporting Standards (“**ESRS**”), to ensure consistency and comparability in SR. The European Reporting Financial Advisory Group (“**EFRAG**”) is tasked with developing these standards.
- **Reporting Obligations:** CSRD imposes mandatory reporting requirements on environmental, social, and governance (ESG) matters, including climate change, biodiversity, human rights, and diversity.
- **Assurance of Reports:** CSRD may require independent assurance of sustainability reports by qualified third parties to enhance credibility and reliability.

CSDDD – what to do

CSDDD is a proposal for an EU directive that aims to address the environmental and human rights impacts of companies throughout their value chains. It seeks to establish a mandatory due diligence framework, requiring companies to identify, prevent, mitigate, and account for the adverse impacts of their operations. The key aspects of CSDDD are:

- **Scope:** The CSDDD is likely to apply to large companies operating within the EU, including their subsidiaries and supply chains, and may extend to non-EU companies supplying goods and services to the EU market.
- **Due Diligence Obligations:** CSDDD would impose obligations on companies to conduct due diligence regarding their environmental and human rights impacts. This includes identifying and assessing risks, implementing measures to address these risks, and monitoring and reporting on their effectiveness.

Overlaps between CSRD and CSDDD



Overlaps between CSRD and CSDDD	CSRD	CSDDD
Focus on ESG factors	CSRD focuses on improving the quality and consistency of SR	CSDDD aims to ensure companies conduct due diligence to identify and address ESG risks throughout their operations and supply chains
Integration of ESG into business practices	CSRD focuses on reporting ESG information, requiring companies to assess and disclose their environmental and social impacts	CSDDD, on the other hand, emphasizes the need for due diligence to identify and mitigate potential ESG risks and impacts
Supply Chain Transparency	CSRD requires companies to report on their value chain, including information on suppliers and subcontractors	CSDDD establishes due diligence obligations on companies to identify and address ESG risks in their value / supply chains
Risk Management	CSRD requires companies to assess and disclose material ESG risks	CSDDD introduces the need for due diligence to identify and mitigate potential ESG risks throughout the business operations and value / supply chains
Reporting and Disclosure	CSRD aims to standardize and enhance SR requirements	CSDDD emphasizes the disclosure of due diligence processes and outcomes

ESG perspective of supply chains



Value Chain: activities related to the production of goods or the provision of services, including the development of the product or the service and the use and disposal of the product as well as the related activities of upstream and downstream established business relationships

Supply Chain: all steps in Germany and abroad that are necessary to produce the products and provide the services, starting from the extraction of the raw materials to the delivery to the end customer and includes: (i) the actions of an enterprise in its own business area, (ii) the actions of direct suppliers, and (iii) the actions of indirect suppliers.

CSDDD

On 13 December 2023, the Council and the European Parliament reached a provisional deal on the CSDDD:

- Large EU companies with more than 500 employees and a net worldwide turnover over €150 million; or Non-EU companies with more than €150 million net turnover generated in the EU, three years from the entry into force of the directive.
- Who else?
- Companies shall adopt plans ensuring that their business model and strategy are compatible with the Paris agreement on climate change. There will be penalties and civil liability for non compliance.
- Compliance with the CSDDD could be qualified as a criterion for the award of public contracts and concessions.

German Supply Chain Act

In force since 1 January 2023, extended scope from 1 January 2024:

- German and non-German companies registered in Germany that have 1,000 (since 1 January 2024) or more employees.
- Who else?
- Companies shall perform human rights, employment rights and environmental due diligence.
- Non-compliance can result in fines of up to 2% of global revenue.

French Law on Vigilance

Adopted in 2017:

- Applies to French companies with over 5,000 employees in France-based subsidiaries or over 10,000 employees in direct and indirect subsidiaries globally.
- Who else?
- Companies shall undertake environmental and human rights due diligence and publish plans to identify and address violations across the supply chain.
- Non-compliance triggers penalties and risk of civil liability.

Achieving sustainability in the supply chain



The sustainability regulatory landscape is complex and understanding the legal requirements is key

5 key milestones in achieving Sustainability in the supply chain:

Due diligence integration and adverse impact identification

1. Company policies and DD questionnaires on human rights, employment and environment.
2. Adoption of measure to identify adverse impact on human rights, employment and environment for own / subsidiaries' / suppliers' operations.

Prevention of potential adverse impacts

1. Development of prevention action plans within the organisation and with respect to suppliers.
2. Application of the prevention plan.

Bring actual adverse impact to an end

1. Adoption and implementation of correction plans with respect to identified adverse impacts to neutralise or mitigate these.
2. Timing is of the essence.

Monitoring

1. Determining of the regularity of monitoring activities.
2. Adoption of procedures for monitoring.
3. Keep up-to-date information about the supply chain.
4. Carry out periodic assessment of own / subsidiaries' / suppliers' operations.

Signals / complaints procedure

1. Providing a possibility for signals / complaints and procedures for their review facilitates compliance.

Legal and Compliance Aspects



The business sees the need of critical decisions resulting from the dynamically changing EU regulatory landscape. ESG compliance is not an easy task, especially when it concerns the entire supply chain.

Key aspects: **Legal**

1. What shall the due diligence include and how to ensure that it gives the wished result.
2. What internal rules need to be adopted and how to implement and monitor these.
3. How companies can manage their supply chain and ensure suppliers' compliance during the contracts' life.
4. Is there a competition law concern when performing the due diligence.
5. Many others.

Key aspects: **Compliance**

1. Be aware of the entire supply chain
2. Establish a risk management system and carry out regular risk analysis.
3. Increased importance of having a vendor management policy in place, taking into account the SCDDD and domestic legislation of specific countries.
4. Whistleblowing reporting channel as an easy tool to report violations of employees' human rights, safety regulations and compliance with environmental requirements.

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