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Trilogue result on the draft EU Supply Chain Directive (Corporate Sustainability Due Diligence Directive - CSDDD) | Position of the Federal Ministry of Finance and the Federal Ministry of Justice

Ladies and Gentlemen,

The Federal Ministry of Finance and the Federal Ministry of Justice have held intensive discussions on the trilogue result of the draft EU Supply Chain Directive (Corporate Sustainability Due Diligence Directive - CSDDD). Both houses cannot support the result. In the Council of the European Union, this has resulted in Germany abstaining, which has the effect of a "no" vote.

As we are aware that this topic is also of great importance to you and that you have contributed intensively to the debate, we would like to briefly explain the result from our perspective.

The starting point of the debate on CSDDD can be described as follows: In the last legislative period, the Grand Coalition passed the German Supply Chain Due Diligence Act. Large sections of the German business community welcomed the goal of finding new ways to fulfil international human rights and labour standards.

enforce ecological standards. Nevertheless, "Germany going it alone" has been widely criticised: A European solution would be preferable.

In addition, the German Supply Chain Due Diligence Act is associated with a considerable bureaucratic burden.

Against this backdrop, it was important to us when the EU Commission, under its President Ursula von der Leyen, launched an initiative for an EU supply chain directive that a possible regulation:

- effectively improves the human rights and ecological situation,
- creates fair competitive conditions in Europe for the German economy (level playing field) and
- The bureaucratic burdens are not increased as much as possible in comparison to the German Supply Chain Duties Act of the Grand Coalition, but ideally designs are found to reduce them.

Our negotiation strategy was to influence the outcome of the negotiations in line with these objectives until the end of the negotiation process. At the same time, however, it was also clear that at the end of the process, the results had to be weighed up against the objectives outlined above in order to arrive at a rational assessment of the outcome.

The Federal Minister of Labour and Social Affairs, Hubertus Heil, who was in charge of the negotiations, has worked hard and with commitment to this end. Measured against what some players in the triad could have imagined, he has achieved considerable negotiating success in line with our objectives. We would like to expressly emphasise and acknowledge this. Nevertheless, the Federal Ministry of Finance and the Federal Ministry of Justice have come to the conclusion that the triad result does not objectively meet the requirements for a good solution. We would like to illustrate this with the following points:

- The triad result would lead to companies being liable under civil law to a considerable extent for breaches of duty in the supply chain. The German government has endeavoured - with considerable partial success - to make the liability regulation more practicable than many of the drafts that were discussed during the negotiation process. Liability is thus limited with the help of tried and tested principles of German liability law, such as the need for the infringed standard to protect third parties.

It also opens up the possibility of sharing audits and jointly fulfilling due diligence obligations as part of industry initiatives. Nevertheless, the liability regulation means a greater burden compared to the German Supply Chain Due Diligence Act, which does not contain a liability regulation, and would place an additional burden on the companies concerned, especially in view of the regulations now envisaged, including those on supplementing the annexes, on the disclosure of evidence and on the statute of limitations.

- In the environmental area, the triologue result deviates from the tried and tested approach of listing the environmental risks covered in a precise and company-specific manner, thereby making companies' due diligence obligations manageable and predictable. A concealed general environmental law clause leads to far-reaching corporate responsibility for environmental damage, irrespective of any specific impact on people.
- In some cases, the design leads to considerable value contradictions with the German legal system. In the environmental sector, NGOs are to be given the opportunity to lodge complaints with companies' own complaints mechanisms, which are geared towards redress, even if they are not affected in their own rights. This is a one-sided departure from the principle of individual legal protection, without taking adequate account of the interests of the companies concerned.
- In addition, the scope of the draft is very broad, meaning that significantly more companies will be affected than under current German law, for example. The construction sector is also to be categorised as a so-called risk sector. These increased inspection and due diligence obligations could indirectly threaten the existence of small and medium-sized companies in the construction sector in particular, which has already been hit by higher interest rates. Our impression is that many companies simply do not have the necessary human and financial resources. It is to be feared that even less will be built in Germany in the future. This would be fatal, especially in view of the current housing shortage.

- Liability risks would be further increased by the fact that the draft directive is based on a very broad definition of the supply chain: For example, the downstream sector is to be covered more broadly than under the Supply Chain Due Diligence Act and, under certain conditions, also include the disposal of products. The very sensible differentiation between direct and indirect suppliers in the Supply Chain Duty of Care Act is also missing.
- The scope of obligations for companies relevant to liability law would also be unclear for the future. This is because it has not been possible to clearly and legally define the EU Commission's authorisation to extend the obligations for companies through delegated acts. In the opinion of the Federal Ministry of Finance and the Federal Ministry of Justice, the delegation option would only have been acceptable if it had been limited to obligations that could be implemented by businesses and if the Member States had been given sufficient opportunity to participate before the Commission's decision. However, this is not the case.
- In addition to the risk of liability under civil law, there is also the risk of administrative sanctions: the trilogue result provides for a mandatory turnover-based fine, not only for serious offences, which is calculated according to a minimum maximum limit of five percent of turnover. Such a regulation appears inappropriate, as there is no clear exception in the text of the regulation that would, for example, allow the turnover-based fine to be waived if the level of wrongdoing is nowhere near as high as in the case of serious misconduct. It is also not apparent why - in addition to civil liability - such a strict regulation should be required in order to adequately and effectively enforce compliance with the duty of care.
- Some well-intentioned simplifications in the fulfilment of due diligence obligations appear problematic in terms of competition policy. For example, the risk assessment should take into account whether a company in the supply chain is itself subject to the directive. However, this is usually the case for large companies. This could prompt companies to focus their demand on such large companies as part of their risk management.

This would therefore create a competitive advantage compared to small and medium-sized companies. There is a risk of the effect of regulation-induced market concentration.

- Furthermore, considerable additional financial, personnel and bureaucratic burdens are to be expected for our companies. For example, larger companies are to draw up a plan to ensure that their corporate strategy is compatible with the Paris Agreement, including concrete reduction targets (so-called climate plan). They should also provide financial incentives for compliance with the climate plan by the management and supervisory bodies. The latter is not compatible with the function of the supervisory bodies and represents a serious interference in corporate governance, especially as this can also affect partnerships due to the legal form neutrality of the directive. The costs and benefits of these measures are disproportionate.
- Ultimately, the result not only violates the criteria of fair competition and a low-bureaucracy solution. It also threatens to worsen the situation in terms of human rights and the environment. This is because German companies in particular are regarded internationally as both investors and purchasers with a particularly high level of sensitivity to human rights and environmental concerns. German consumers simply expect this from them. If German companies find themselves unable to manage their liability risks properly in future and as a result increasingly withdraw from international supply relationships and investment activities in emerging and developing countries, there is a risk of double damage: The advantages of international division of labour are lost in the event of such reshoring. In addition, other companies, for example from China, are likely to take their place, whose human rights and ecological sensitivity will certainly not improve the situation in the countries concerned.

Since Russia's attack on Ukraine at the latest, nobody can close their eyes to the fact that the geopolitical framework conditions have changed. Diversification of supply chains (de-risking) is unavoidable.

We need stronger networking instead of new one-sidedness in our economic relations.

Europe must find its place in the systemic competition between the USA and China and needs a strong, competitive economy in order to assert itself in the world. We should not and must not sacrifice the protection of human rights and responsibility for the environment to achieve these goals. On the contrary: these are values that we as the EU stand up for. Our companies should also be ambassadors for these values. In the fight for our values, however, we as the EU also need a new realism and must not shackle ourselves in the wrong way with bureaucratic regulations. Because that would not help anyone.

Yours sincerely



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