ISDA

Responses to questions 31 – 35 of EC consultation on CSDDD due diligence guidelines

31. What is your experience of cooperating with business partners to ensure efficient due diligence?

The term "business partner" could cover a wide range of potential different business relationships, ranging from genuine partnerships (for example, where two companies collaborate to produce a joint product, or where a business partner may be viewed as involved in or connected with any human rights or environmental breaches committed by the in-scope entity) to any supplier, contractor, distributor or service provider linked to a company's operations (including SMEs and third-country entities within the value chain), whether the relationship is direct (contractual) or indirect (multi-tier supply chains).

The ability of an in-scope company to cooperate with business partners to ensure efficient due diligence will vary depending on what is intended by the term "business partner". Where an in-scope company establishes a partnership relationship with another company, with the ability and power to negotiate compliance with specific requirements, the experience will be very different from a situation where an in-scope company has a relationship with a supplier where the in-scope company is just one of many customers for the supplier.

Similarly, some types of in-scope company (for example, financial institutions) will have a very significant number of supplier arrangements and requiring them to obtain positive acknowledgement of every cascading contract will result in practical and legal challenges.

Examples of challenges in obtaining contractual commitments from business partners include:

- **Duplicative and conflicting codes of conduct**: If the business partner deals with large numbers of in-scope companies, it may not be possible for it to commit to comply with the code of conduct established by each of those companies. For example, a business partner dealing with 500 in-scope companies will not realistically be able to commit to comply with 500 different codes of conduct and may ultimately become unable to on-board further in-scope companies if it is unable to determine whether their codes of conduct are consistent with those with which it has already committed to comply.
- **Closing off access for in-scope companies to certain suppliers**: If the model clauses are too onerous, in-scope companies may no longer be able to access services from some suppliers, particularly in developing markets. In-scope companies should be able to develop an approach that takes into account local national laws and offers

simplified, tiered frameworks calibrated to business partner capacity. An in-scope company should not be in breach merely because a developing-market partner cannot match an OECD supplier's assurance level.

- **Challenges with seeking to impose specific contractual obligations**: Contractual terms including cascading assurances, prevention or correction plans, and verification obligations are often unworkable in practice. Indirect upstream partners, particularly those in developing markets, may lack the institutional capacity or commercial incentive to make these assurances. Financial institutions have already experienced challenges with other requirements to obtain contractual commitments, for example in the context of Article 55 and 71A BRRD, or in the context of the requirement to obtain Legal Entity Identifiers (LEIs) from counterparties under EMIR. Counterparties want to understand their potential liability under a contract and protect themselves (and their customers, stakeholders and others) as best they can. If agreeing to a specific clause may involve additional cost or liability, they may be unwilling or unable to agree to it.

32. What cooperation should the model contract clauses recommend between the in-scope company and its business partners as regards:

- **the adoption and implementation of any prevention/correction action plan**
- **the cost of addressing adverse impacts**
- **stakeholder engagement**
- **the notification and complains mechanisms**

with a view to ensure that due diligence is efficient and cost effective while compliance burden is not shifted to the business partners? Please provide examples of appropriate contractual clauses, if possible.

While we acknowledge that model clauses can be a helpful resource for in-scope companies, there are limits on what a model clause can achieve in the context of ensuring effective due diligence.

CSDDD only indicates that companies should seek contractual assurances from business partners that they will ensure compliance with the company's code of conduct and (as necessary) a prevention action plan. If a model contractual clause seeks to go beyond this, it is likely to be challenging to translate into contractual terms (at least in a way that a counterparty will accept).

Any model clauses should provide examples by way of guidance but it should be clear that model clauses are purely voluntary and do not provide a benchmark for assessment

of compliance. Model clauses will inevitably need to be tailored to address specific scenarios, specific applicable laws and regulatory requirements and specific services, products or relationships. As a result, we would support model clauses that provide examples of approaches that may be taken, on the understanding that in-scope companies may elect to use some or none of the model clauses, and that an in-scope company can be compliant with CSDDD without using the model clauses or anything directly comparable.

Any model clauses should be appropriate for inclusion within other agreements, rather than requiring a standalone agreement governing due diligence. If the intention is to include the model clause (or part of it) in standard terms of business or other agreements that govern provision of specific services rather than the broader relationship between the parties, the clause should be focussed on the specific issue of efficient due diligence under CSDDD rather than potentially replicating issues (such as notice provisions and liability) that are likely to be addressed already under the agreement. We discuss this further below, but some of the points raised by the Commission in this question are likely to be complex to address and beyond the scope of a single clause. For example, if the intention (as indicated by the Commission in its consultation) is that the relevant contract should not be rendered void or trigger termination rights upon occurrence of an adverse impact, how would this sit alongside the liability provisions and general principles of contract law regarding remedies for breach of terms of the contract? Similarly, if the clause is intended to address the occurrence of any possible adverse impact, it may be necessary for the parties to agree at a later date how to deal with the relevant adverse impact (rather than being able to address this in the clause itself), which may in turn have an impact on the enforceability of the clause under the governing law of the contract.

On the specific points raised by the Commission in this question:

- **Adoption and implementation of a prevention / correction action plan**: We understand that an in-scope company is only required to develop a prevention action plan where "necessary due to the nature or complexity of the measures required for prevention", meaning that an in-scope company's prevention action plan may only be developed after it has established a relationship with a particular business partner. Similarly, a business partner should only be required to assist in developing and implementing a corrective action plan if it has some responsibility for causing the adverse impact, rather than requiring the company to provide assistance regardless of whether it contributed to the impact or not. The development of such plans for preventative and corrective measures is also generally most effective when undertaken by the entity directly responsible for the relevant business relationships that cause the potential or actual adverse impact. As a result, it may not be appropriate for a business partner to commit contractually to adoption and implementation of a prevention / correction action plan, without knowing what it is agreeing to, and a clause that seeks to commit a party to take unspecified future action with respect to unspecified adverse impacts risks being unenforceable on the grounds of uncertainty. This principle is particularly relevant for financial holding undertakings that are not involved in the day-to-day operations and management of their independently managed portfolio company subsidiaries. Contractual arrangements relating to action plans should thus permit reliance on subsidiary-level due diligence processes (and should not impose direct obligations on any parent undertakings), subject to appropriate oversight and monitoring by the parent undertaking.

- **Cost of addressing adverse impacts**: Any agreement on cost-sharing will depend heavily on the level of responsibility or involvement that the business partner has in the relevant adverse impact. It is likely to be extremely difficult to establish this at the outset of the contract, and also extremely unlikely that any business partner would agree to accept contractual liability for undetermined costs to be incurred at an indefinite date in the future, with no ability to limit that liability (e.g., usually a company would only accept liability where it bears some degree of responsibility for the relevant adverse impact, or where the relevant adverse impact has occurred as a result of the company's negligence or wilful default).
- **Stakeholder engagement**: The nature, timing and extent of any stakeholder engagement will very much depend on the adverse impact that has been identified and the stage that the in-scope company has reached in handling the adverse impact. This is not easily addressed in a contractual clause, and particularly not in a model contractual clause that is not tailored to any specific industry, adverse impact or stakeholder base. In addition, in-scope companies and their business partners may have legal or commercial requirements that govern their stakeholder engagement. For example, listed companies may be required to disclose information to the public at specific times and in specific ways. Regulated companies may be expected to disclose information to their senior management and regulator. These types of issue may make developing a co-ordinated stakeholder engagement strategy challenging and potentially counterproductive.

  If provisions on stakeholder engagement are included in a model clause, it should be made clear that in-scope companies may decide whether or not they consider it appropriate and proportionate to address stakeholder engagement in this way. If such provisions are included, active stakeholder engagement should only be required for impacts that proceed to in-depth assessment, rather than requiring it during scoping.

- **Notification and complaints**: We understand that the reference to notification and complaints is intended to refer to a provision along the lines of Article 14 CSDDD, which requires in-scope companies to enable specified persons to submit complaints to them where they have legitimate concerns regarding actual or potential adverse impacts. It is unclear what the model clause would need to address with respect to complaints in this regard. The obligation under Article 14 CSDDD falls on the in-scope company itself, so there is no obligation for the in-scope company to refer complaints to a business partner (and this would not remove the in-scope company's obligation to deal with complaints in any event).

33. In situations where the in-scope company and its business partner(s) are located in different countries, is there a need for specific contractual clauses on jurisdiction and applicable law to the contract? If so, why and can you provide examples of such clauses?

We understand that this question is asking whether a specific governing law / jurisdiction provision is needed in connection with the model clause, rather than for the contract as a whole. It would be very unusual for a commercial contract not to have any governing law / jurisdiction clause, particularly where the in-scope company and its business partner are established in different countries.

Specific governing law or jurisdiction provision for the model clause: We do not consider that there is a need for a specific governing law / jurisdiction provision applicable to the clause, either where the in-scope company and its business partner are located in different countries, or in any other circumstance (e.g., where the in-scope company is contracting under foreign law – for example where a French company enters into a New York law ISDA). Having a specific governing law provision applicable to the clause would not improve the likelihood of it being effective and enforceable before the courts of any specific jurisdiction, and subjecting this specific clause to the law of an EU Member State (where the contract as a whole is subject to another governing law) makes it significantly more likely that non-EU counterparties will challenge inclusion of the clause. In particular, some counterparties may only be permitted to contract under local law, meaning that they would be unable to accept a clause on this basis and so EU counterparties may not be able to continue to deal with them, introducing a new barrier to cross-border trade and putting EU counterparties at a disadvantage.

This may also require forms to obtain new legal opinions, depending on the nature of the contract in which the clause is included, and in some cases these opinions may not be favourable.

In addition, if the EU sets a precedent of requiring specific clauses to be governed by the law of an EU, other jurisdictions may use this as justification for imposing similar requirements. There are well-established principles for recognising choice of governing law and foreign law judgments, and if firms go down the route of having multiple governing laws for different parts of their contracts, this may start to undermine these principles.

Dealing with conflicting legal and regulatory obligations: In-scope companies such as financial institutions which operate across multiple jurisdictions need model clauses that respect local mandatory legal requirements (such as data protection laws and blocking regulations) which can directly conflict with CSDDD information-gathering. The model clauses should address situations where local law conflicts with CSDDD requirements. Further, the guidelines should provide a safe harbour, confirming that a documented, good-faith effort to acquire information should satisfy the scoping or in-depth assessment standard where there are genuine legal barriers.

34. Are there other elements required by CSDDD that are challenging to translate into contractual terms? What could be ways to overcome this challenge?

As mentioned in our response to question 32, CSDDD only indicates that companies should seek contractual assurances from business partners that they will ensure compliance with the company's code of conduct and (as necessary) a prevention action plan. If a model contractual clause seeks to go beyond this, it is likely to be challenging to translate into contractual terms (at least in a way that a counterparty will accept). In particular, if the Commission considers that the contractual assurances should effectively replicate the requirements of Articles 6 – 15 CSDDD, this is going to cause significant difficulties in obtaining any contractual assurance from counterparties.

Specific elements that are likely to present challenges include:

- **Verification**: It is unclear what it means for assurances to be "accompanied by appropriate measures to verify compliance" (e.g. if this is an objective standard), or when third-party verification is expected. This will depend on the context of the relationship, and companies should have commercial discretion to implement verification only to the extent they consider it necessary.
- **Stakeholder engagement**: Stakeholder engagement is context-dependent and difficult to set out contractually. Companies and their partners should have discretion over when and how to engage.
- **Information requests**: The CSDDD does not specify the format of information requests, which may increase variability and regulatory burden. In line with advocacy by some Member State governments, we support standardized, interoperable formats for requests across the CSDDD and other EU frameworks.

The Commission's guidelines should also clearly endorse non-contractual compliance pathways, such as participation in industry initiatives, as full alternatives where contractual mechanisms are impracticable or unlikely to achieve a significantly better outcome.

In addition, where an ultimate parent company, which is a financial holding undertaking that is not involved in the day-to-day operations and management of their subsidiaries, falls within the scope of the CSDDD, it is likely to prove challenging in practice for such parent company to require certain contractual terms to be included in contracts between its subsidiaries and their business partners. As such, any requirements in this regard should be limited to the subsidiaries themselves that are directly within the scope of the CSDDD.

35. Are you aware of any useful and relevant best practices for contractual clauses operationalising human rights and environmental due diligence? If yes, elaborate.

The main precedent that we are aware of is the series of model contractual clauses addressing human rights issues published by the American Bar Association in 2021[1].

One key point to note in relation to these model clauses is that these require both parties to develop their own policies around human rights issues, rather than seeking to impose one party's code on the other.

[1] https://www.americanbar.org/content/dam/aba/administrative/human_rights/contractual-clauses-project/mccs-full-report.pdf