

Faculty of Law,
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REGULATING SUPPLY CHAINS
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Based on the Working Paper 'Regulating Supply Chains' (with Dr. Julia Slnnig)

§ 1 – Sedes materiae

§ 2 – Supply Chain Regulation Models

§ 3 – CSDDD

§ 4 – Critical Assessment

§ 5 – Conclusion

§ 1 - Double Materiality: Sustainability Risks & Impacts

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Environment & FI:
public goods not
adequately priced by markets
=> case for regulation

Sustainability
Dimensions

Sustainability Risks
(internalized
externalities)

Impact on Sustainability
Factors (externalities)

Perspective:
Value of own
private Goods
(Portfolio)

Perspective:
Public Goods

Sustainability Risks: rising costs due to ESG factors

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Risk	Relevance for Supply Chain	Risk Management
Rising sea level, more severe storms	Unreliable transportation	More stock, „make“ > „buy“, but: supply of raw ingredients?
Droughts: Shortage of water supply for farmland and population	Unreliable production	Irrigation systems; new wells; desalination OR more stock, „make“ > „buy“ (s.a.)
Social crisis, political instability	Coup d'état, Strikes => unreliable production and transportation	Reallocation of production OR More stock, „make“ > „buy“ (s.a.)
Health crisis (Covid)	Unreliable transportation	More stock, „make“ > „buy“

All RM measures capital intense =>
 Consumer prices? Competitiveness?
 Supply of raw ingredients=

Sustainability Impacts: how a firm influences ESG factors

Firm's measures	Sustainability Impact	Mitigation	Adaptation
Emitting GHG	Global warming (rising sea level etc.)	Reduce GHG Emissions	Location-specific, eg build dams, water irrigation systems
Purchasing raw minerals	Deforestation, impact on marine territory (where raw minerals are sourced in rain forest, sea) => reduced biodiversity; global warming	Define, monitor minimum level of ESG standards for suppliers; avoid ESG intensive supply	Define offsetting strategy (plant new trees; pay for protected areas etc)
Exerting price pressure on suppliers	Undercutting of ESG standards	Define, monitor minimum level of ESG standards for suppliers; pay more	?
Donations to local power factions / corruption	Potential corruption	1) Corporate donation GL 2) Transparency 3) Avoidance	?

All mitigation measures capital intense =>
Consumer prices? Competitiveness?

§ 1 – Sedes materiae

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- **Sustainability risks** impact on the firm's income and profitability; the firm's risk management requirements and the directors' duties include to address sustainability risks; which may include bearing the respective sustainability risk if / at long it is profitable
 - **Sustainability impacts** impact on public goods and other people's income and profitability. These are, in the absence of contractual commitments (for instance in prospectuses) not part of the firm's risk management and directors' duties of care. Sustainability impacts are the subject, for instance, of environmental laws (eg prohibition to pollute)
- => Supply chain regulation is about **reducing adverse sustainability impacts**.

§ 2 – Models of Supply Chain Regulation

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« upstream »

« supply »
production of goods &
provision of services

« downstream »

« demand »
distribution, transport, storage of
goods to customers / clients

Regulatory Option	Regulatory Tools	Challenge	EU Actions
Doing nothing	(-)	Rests on pricing at markets; markets poor on pricing public goods; potentially asocial effects	n.a.
Self-regulation	Codes of conduct; labelling	Non-binding; less effective where costly	[multiple industry standards]
Regulating Suppliers	Environmental & Social Laws	Rigor of supply countries; territorial restrictions	Multiple international conventions
Pricing public goods	Taxation (example: carbon tax)	Works for measurable goods in regional limited settings	Carbon pricing & trading mechanism (2023)
Indirect impact on suppliers via EU producers	Transparency; market-based incentives	Measuring impact? Elasticity of markets? Materiality for demand side?	SFAP: Taxonomy Regulation, SFDR etc. [since 2019]
Direct regulation of EU producers & service providers; indirect impact on suppliers	Mandatory due diligence of, compliance standards for, supply chain	Costs? Competitiveness	Selected areas - Conflict Minerals Regulation - Diamonds - Fish <u>All: CSDDD [2024]</u>

§ 2 – Models of Supply Chain Regulation (« SCR »)

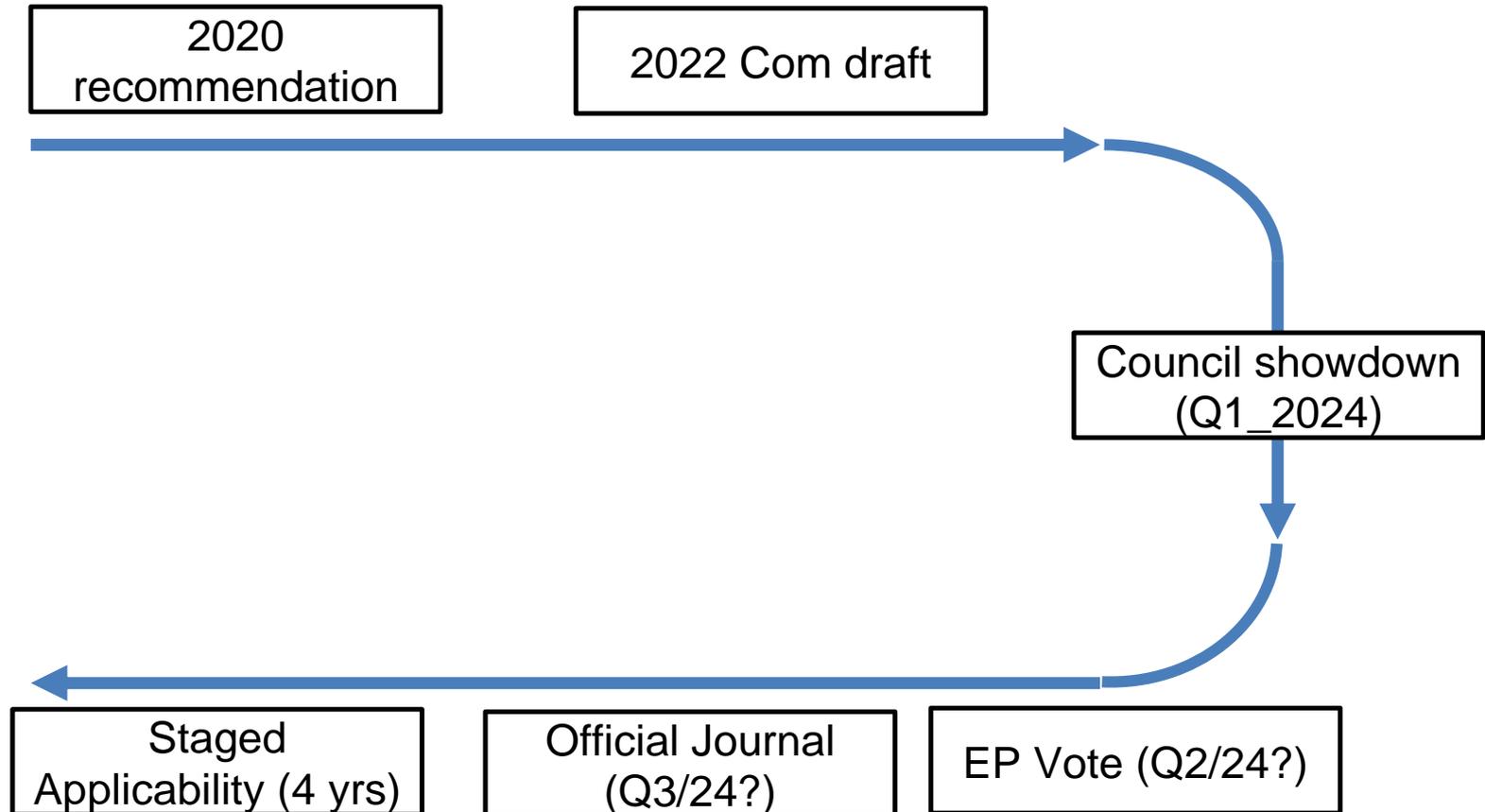
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- **SCR: reducing adverse sustainability impacts.**
- Technical approach: expand corporate risk management to include externalities (model: Sustainable Finance regulation)
- **CSDDD to expand a regulatory model established in the EU for risk-prone supply goods («blood diamonds», fish) to all goods and services.**
- **Examples from Neighbouring Countries: France, Germany**

§ 2 – Legislative Process of CSDDD

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1. Scope
2. Due Diligence Duties
3. Standards to be screened
4. Enforcement
5. Focus points for Luxembourg

1. Company & Group of Companies

- All entities subject to EU accounting law
- Partnerships excluded

2. Size Thresholds

- 1,000 employees and /or 450 Mio. € worldwide net turnover
- Group licenses: 22.5 Mio. € in EU royalties + 80 Mio. Net Turnover

3. EU nexus

- Registered office in Member State or
- EU turnover, royalties sufficient to meet size thresholds

§ 3.1 – Scope

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Ultimate Parent Company (UPC)



4. Sectorial exemptions

a) Regulated Financial Institutions (fund managers, banks)

- Rules apply to « upstream supply chain » only
- problem: intermediaries stand in between – no clear « supply »
- supply of capital or supply of investments?

b) Agriculture

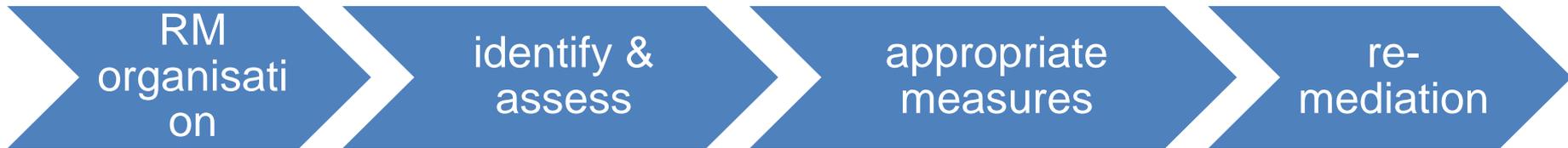
c) Other

§ 3.2 – CSDDD Duties

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1. Organize (« risk management »), cf Art 5



2. Liability for violations

3. Climate Change Mitigation Plan

§ 3.2 – CSDDD Duties: Risk Management (Art 5, 7, 8, 8d to 11)

- **Expanding risk management duties to externalities => financial regulation (April 2021 package)**
- **Clarification in recitals: « obligation of means », not « obligation of result »; best effort basis => no warrant that no adverse impact happens, but steps to reduce likelihood**
- **« risk-based approach »: in risk-prone fields firms must take more detailed measures than in others. Focusing resources is key. Screening basis for « risk-based approach »**

§ 3.2 – CSDDD Duties: Risk Management (Art 5, 7, 8, 8d to 11)

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Integrating due diligence for adverse impacts into RM systems and policies

Preventing, mitigating, minimising (potential) adverse impacts

Meaningful engagement with stakeholders

Adverse impact notification system and complaints procedure

Monitoring effectiveness of RM measures

Communicating about Due Diligence

Group-wide approach, cf Art 4 (2), 4a

**Presentation by
Basak Baglayan
on Supply Chain Due Diligence**

Bringing actual adverse impacts to an end (Art. 8)

Measures capable of achieving the objectives of due diligence by effectively addressing adverse impacts in a manner commensurate to the degree of severity and the likelihood of adverse impact, and reasonably available to the company

=> Proportionality test

§ 3.2 – CSDDD Duties: Remediation, cf Art 3(1)(qe), 8c

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Restitution of the affected person(s), communities or environment to a situation as close as possible to the hypothetical state without the adverse impact, proportionate to the company's implication therein, incl financial and non-financial compensation and reimbursement of costs.

Caused only by Business Partner:
Voluntary remediation
Influence on Business Partner

Caused (also) by Company:
Mandatory remediation, Art 8c (1)



reimbursement of costs,
compensation of damages,
substitution (planting trees, water irrigation systems)

§ 3.2 – CSDDD Duties: Liability for violations, Art 22

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(1) Damaged caused to a natural or legal person

(2) Company failed to comply with duty to
a) prevent potentially adverse impacts
b) bring an adverse impact to the end

(3) Intentionally or negligently

=> Burden of proof? « lightened » by CSDDD

Transition plan to put into effect for climate change mitigation which aims to ensure that the business model is compatible with the transition to a global economy and the limiting of global warming to 1,5°C in line with the Paris Agreement and the objective of climate neutrality.

=> so far: disclosures

=> CSDDD: from voluntary to mandatory, paired with pan-European enforcement in case of non-compliance (Art 15 (5))

=> But: CSRD introduces transition plan. CSDDD to fill gaps re third country issuers.

§ 3.3 – Standards to be screened

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« actual and potential human rights adverse impacts and environmental adverse impacts »

1. Rights and Prohibitions in International Human Rights Instruments
2. Human Rights and Fundamental Freedoms Instruments
3. Prohibitions and obligations included in Environmental Instruments

Long list in Annex I (10 pp.)

§ 3.4 – Enforcement

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Public Enforcement

- Supervision (Art 17)
- Administrative injunctions & sanctions, Product Ban (Art 18)
- Anonymous whistleblowing (Art 19, 23)
- Penalties, name & shame (Art 20)
- Court orders (Art 19(5))
- Exclusion from public procurement (Art 24)

Private Enforcement

- Standing to sue to
- damaged persons, communities (Art 22)
 - representatives of civil societies (NGOs) (Art 22(2a))
- Support on litigation costs, Art 22(2)
Reducing level of evidence, Art 22(2)

§ 3.5 – Focus points for Luxembourg

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- **Regulated financial institutions, cf Art 3 (1) (iv)**

- => CSDDD only upstream; application of OECD MNE guidelines

- => includes financial holding companies

- => for some FIs, what is upstream is difficult to determine

- => Implementing discretion may

- **Explicit exemptions**

- => for investment funds [AIF and UCITS, cf Art 2 (7)]; but Managers of AIFs and UCITS ManCos in scope

- => pension funds under the IORP Directive *where MS determine it*

- => Good! Uncertainty who is supply/demand; existing regulation under SFDR; costs

§ 3.5 – Focus points for Luxembourg

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▪ **Corporate Groups [Art 2 (1)(b), (ba), (2)(b)ba), (2a)]:**

(1) Group subsidiary or Ultimate Parent Company [UPC] > thresholds

(2) Group collectively > threshold + UPC to file consolidated account

(3) Exemption for Non-operating holding companies: one EU subsidiary entitled and empowered to fulfill CSDDD duties for the group, at risk of joint liability of UPC and subsidiary.

(4) Financial holding companies: treated as regulated financial institution => CSDDD duties only upstream (« supply »)

1. Costs?

2. Legal uncertainty?

- CSDDD implemented by MS. MS to reduce legal uncertainty.
- EU Com's guideline and model contracts to harmonize, but itself costly.

3. Overriding EU SFAP?

- CSDDD prior to assessment of disclosures under SFDR, CSRD. Partly repetitive, but entirely different instrument.

4. CSDDD within « System of EU law »?

- Uncertain how CSDDD fits into EU law: a) company law?, b) environmental law?, c) financial regulation?, d) private law, d) consumer protection?

§ 4 – Critical Assessment: opportunities

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1. ESAP

- Utilizing of ESAP to address information asymmetry re sustainability information (here adverse supply chain impacts)

2. Expansion to third countries

- Rules include third country firms offering goods/services in EU. [Yet, EU firms earlier in the net than TC firms].

3. Integration into OECD MNE and CSRD

- Applicable standards to large firms & « multi-national enterprises » [but strict enforcement]

§ 4 – Critical Assessment: opportunities

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4. All business models covered?

- Pure platform market places: upstream/downstream of CSDDD?
 - Who enforces EU rules vis-a-vis platform sellers?
- => Focus of OECD MNE reviews [more from Basak]

§ 5 – Conclusions & Takeaways

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- CSDDD to increase
 - (1) documentation, processes to mitigate risk of litigation;
 - (2) legal uncertainty (eg. fairness » of contract terms with SMEs?);
 - (3) overall costs of doing business in EU.
- Companies in scope of CSDDD subset of « large entities » under EU accounting law (ie. CSRD); many rules aligned re measurement of adverse impacts and climate change mitigation; some third-country entities added to scope: 'increasing rivals' costs'.
- **Lux perspective:** CSDDD better than earlier drafts. Alignment with SFAP and ESAP. Costs for FIs and holdings reduced. Uncertainty on « upstream » for some intermediary business. Platform business deserve consideration.

Thank you!

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www.ssrn.com/abstract=4278277



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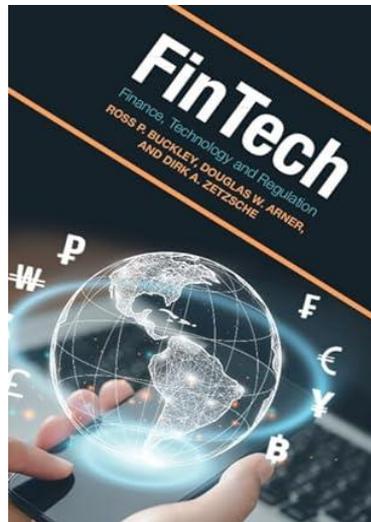


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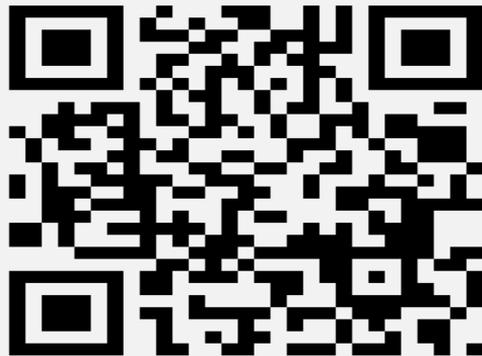
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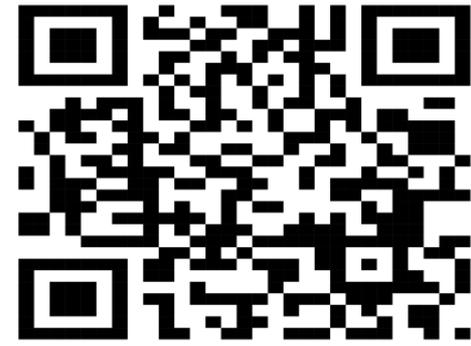


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Thank you!