RCP Policy Brief

What the EU Corporate Sustainability Due Diligence Directive Says About Contracts

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On July 5, 2024, the Corporate Sustainability Due Diligence Directive (CSDDD)[2] was published in the Official Journal of the European Union. It will enter into force on July 25, 2024 and Member States will have to transpose the Directive into national law by July 26, 2026. Now that the text is finalised, we can analyse its requirements with respect to commercial contracts, which are one of the key tools that companies are expected to employ in meeting their human rights and environmental due diligence (HREDD) obligations.

Although the CSDDD establishes due diligence standards only for large EU businesses and non-EU businesses generating significant revenue in the EU[3] (a corporate seat is not required), it will have major implications well beyond those companies. That is because they will have to implement the due diligence requirements in their own operations, as well as in the operations of their subsidiaries and business partners to the extent the latter are involved in the company's "chain of activities."[4][5] It is therefore helpful to think of the Directive's scope as covering not just individual companies, but also the companies' commercial relationships, which are often mediated through contracts.

Contracts have long been vehicles of choice for companies to implement human rights and environmental (HRE) standards across their supply chains.[6] As privately negotiated instruments, contracts are flexible and allow companies to set tailored, relationship-specific, standards for performance with their business partners. But contracts are also legal instruments, meaning that the commitments and performance standards they contain are binding, even in the absence of local (or other) legislation. This is why contracts can fairly be described as the legal links of global supply chains.

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[2] Directive (EU) 2024/1760 of the European Parliament and of the Council of 13 June 2024 on corporate sustainability due diligence and amending Directive (EU) 2019/1937 and Regulation (EU) 2023/2859.

[3] Article 2 sets out the CSDDD scope, clarifying that both EU and non-EU-companies will be subject to HREDD requirements.

[4] As explained in the Human Level briefing note, "The 2024 EU Corporate Sustainability Due Diligence Directive: What the Final Text Says" (March 2024): "The fact that the Directive doesn't apply to as many companies as initially envisioned doesn't matter. A much greater number of companies will be affected by this Directive, by virtue of how the Directive's expectations will in turn shape contracts, investor questions, supply chain expectations, and other drivers for responsible business conduct."

[5] The chain of activities includes all upstream activities of companies' business partners if they are related to the production of goods or the provision of services by that company (including the design, extraction, sourcing, manufacture, transport, storage and supply of raw materials, products or parts of products and the development of the product or the service); downstream activities are limited to distribution, transport and storage of company products, if carried out for or on behalf of the company, Article 3(1)(g).

[6] Lise Smit et al., European Commission, Study on Due Diligence Requirements Through the Supply Chain, Final Report (2020) (finding "[c]ontractual provisions and supply chain codes of conduct remain one of the most frequently used tools for implementing supply chain due diligence, but enforcement of contractual obligations on suppliers' due diligence are problematic, and in any event only available where there is a direct contractual relationship, such as with first tier suppliers").

Understanding their significance, the CSDDD drafters have, in each iteration of the Directive's text, carved out a special role for contracts in carrying out HREDD. Indeed, contracts feature prominently in Article 10 on preventive measures and Article 11 on corrective measures. There can be little doubt that the transposition of the CSDDD will further increase the relevance of contracts as tools for implementing HREDD in supply chains, so it's important to get them right.[7] This brief provides some answers to the "how to get the contracts right" question, along with a chart summarising the dos and don'ts of due diligence-aligned contracting (on last page).

Before launching into the analysis, we want to underscore that, while contracts are important vehicles for implementing effective HREDD, they are not a silver bullet: Companies cannot expect their HRE issues to be solved simply by changing their contracts. HREDD is a comprehensive process that extends far beyond contracts and requires continuous engagement and monitoring. Likewise, while contracts are an important component of a robust HREDD process, they are not a proxy for it: Companies cannot expect to meet the CSDDD requirements simply by adding certain clauses to their contracts. This is addressed in the CSDDD, which clarifies that companies cannot contract their way out of their due diligence obligations.[8] Contracts can and must be (re)designed to strengthen the foundation for effective HREDD, but even the best contracts cannot replace HREDD.

The CSDDD's appropriateness requirement allows *and* limits company discretion in designing and carrying out HREDD

While the CSDDD imposes an obligation for companies to conduct HREDD, it does not specify a rigid formula for doing so. There is no one size fits all when it comes to due diligence. Each company will be expected to demonstrate that it is 'doing its homework' to identify, prevent, mitigate, and, as needed, remediate adverse impacts in its chain of activities. Importantly, companies are not expected to have zero (potential and actual) adverse impacts in their chain of activities. Rather, they are expected to have a robust risk-management system in place to proactively identify, prioritise, and address impacts as they arise. This is what is meant by saying that due diligence is an obligation of means, rather than results.[9]

The process-based due diligence regime gives companies a lot of flexibility in how they design and implement due diligence measures, including their contracts. This flexibility is not boundless, however: Companies must employ *appropriate measures* to carry out their due diligence, as defined in Article 3(1)(o) and further set out in Articles 10(1) and 11(1).[10] We discuss appropriateness in more detail below, but important to note for now is that, to be appropriate, due diligence measures must be *effective*, meaning that they must be designed and evaluated on the basis of their capacity to actually achieve the objectives of HREDD. In addition, Article 15 (Monitoring) states that due diligence measures,

[7] Article 18 sets out that the European Commision will adopt guidance on model contractual clauses within 30 months of the CSDDD entering into force. This means we can expect official guidance by the end of 2026.
[8] Recital 66 (The guidance on model contract clauses (...) should reflect the principle that the mere use of contractual assurances cannot, on its own, satisfy the due diligence standards provided for in this Directive.")
[9] See Recital 19 ("This Directive should not require companies to guarantee, in all circumstances, that adverse impacts will never occur or that they will be stopped. For example, with respect to business partners, where the adverse impact results from State intervention, the company might not be in a position to arrive at such results. Therefore, the main obligations in this Directive should be obligations of means.").
[10] Article 3(1)(o) and Recital 19.

including contracts, must be regularly monitored for effectiveness to ensure that they are in fact doing the job they were designed to do.[11]

The requirements of appropriateness and effectiveness set boundaries around how companies can meet their due diligence obligations, limiting companies' ability to simply tick-box their way to compliance.[12]

Contracts must be appropriate

The CSDDD identifies contracts as preventive and corrective measures that companies will be expected to employ, where relevant and feasible, to meet their due diligence obligations. Article 10 (Preventing adverse impacts) and Article 11 (Bringing actual adverse impacts to an end), both speak directly to contracts and require companies to "seek contractual assurances from direct business partners that they comply with the company's code of conduct and, as necessary, with the company's prevention action plan" or with the company's "corrective action plan".[13]

As preventive measures, contracts must be designed "to prevent or, where prevention is not possible or immediately possible, adequately mitigate potential adverse impacts that have been or should have been identified."[14] As corrective measures, contracts must be designed "to bring actual adverse impacts that have been, or should have been, identified [...] to an end."[15]

Read together with the relevant recitals,[16] Articles 3(1)(o), 15, 10, and 11 instruct that, unless contracts are appropriate and effective, they will fall short of meeting the new legal requirements. This begs the question: *What is an appropriate, due diligence-aligned contract? What contracting practices does the CSDDD rule out and in?*

For contracts to be appropriate, they need to be capable of *effectively* addressing adverse impacts in a way that is commensurate with the severity and likelihood of the impact, as well as with the company's level of involvement in the impact.[17] Account must be taken of "the circumstances of the specific case,

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[11] Article 15 (Monitoring) requires Member States to ensure that companies carry out periodic assessments of their own operations and measures, as well as those of their subsidiaries and business partners, to assess and monitor the adequacy and effectiveness of the due diligence process.

[12] Bueno N, Bernaz N, Holly G, Martin-Ortega O. The EU Directive on Corporate Sustainability Due Diligence (CSDDD): The Final Political Compromise. Business and Human Rights Journal (2024) 3-4 (https://doi.org/10.1017/bhj.2024.10)

[13] Article 10(2)(b) and Article 11(3)(c): Companies must "seek contractual assurances from a direct business partner that it will ensure compliance with the company's code of conduct and, as necessary, a prevention action plan [or corrective action plan], including by establishing corresponding contractual assurances from its partners, to the extent that their activities are part of the company's chain of activities."

[14] Article 10(1).

[15] Article 11(1).

[16] Even though recitals are not binding, they are regularly used to interpret the text of EU legislation, in particular to resolve issues of clarity. Recitals 46, 54, and 66 provide useful guidance to interpret what "appropriateness" means for contractual obligations and purchasing practices.

[17] Article 3(l)(o) and Articles 10(1) and 11(1): When designing appropriate measures, companies should consider the degree and nature of a company's involvement in an adverse impact (cause, jointly cause, directly linked); whether the adverse impact could (or did) occur in the company's own operations or in those of a subsidiary, a direct business partner, or an indirect business partner; and how much influence the company has over the business partner that could (or did) cause or jointly cause the adverse impact.

including the nature and extent of the adverse impact and relevant risk factors."[18] Rather than operating on their own, contracts must be designed to support a broader, context-specific, and dynamic process for identifying, preventing, mitigating potential adverse impacts and for correcting and remediating actual adverse impacts.

Here are some factors to be considered in determining the appropriateness of due diligence measures, including contracts:

- *Company involvement*: The closer the company is to the impact, the more involved it is in the impact, the greater the due diligence expectation will be. Specifically, contracts should be designed considering that adverse impacts could be (or an actual adverse impact was) caused by the company alone, or caused jointly by the company and a subsidiary or business partner, or caused only by a business partner.[19]

- *Severity and likelihood*: The more severe and likely the impact, the greater the due diligence expectation will be.

- *Influence*: The more influence the company has on business partners that are causing or jointly causing adverse impacts, the greater the due diligence expectation will be. Influence also matters for determining the type(s) of measures that companies are expected to employ in order to address adverse impacts effectively.[20] That being said, the CSDDD recognizes that companies are not always able to influence the conduct of the businesses in their chain of activities. This is why the definition of appropriate measures includes the qualifier that measures must be "reasonably available to the company."[21] This creates some allowance for companies with little influence or resources. Nevertheless, even companies that have little (or no) influence are expected to take measures to increase their influence. Although this is not specifically set out in the Directive, one way to increase influence could be to contract with indirect business partners.[22]

Appropriateness gives companies latitude in designing their due diligence measures, shielding them from being overburdened with unrealistic, prescribed, one-size-fits-all requirements. But it also restricts that latitude by establishing due diligence criteria: Not just any due diligence measures will do, only appropriate and effective ones. Since the Directive shields even the in-scope companies from

[18] Article 3(1)(u): "'risk factors' means facts, situations or circumstances that relate to the severity and likelihood of an adverse impact, including company-level, business operations, geographic and contextual, product and service, and sectoral facts, situations or circumstances."
[19] Articles 10(1) and 11(1): When designing appropriate measures, companies should consider the degree and nature of a company's involvement in an adverse impact (cause, jointly cause, directly linked); whether the adverse impact could (or did) occur in the company's own operations or in those of a subsidiary, a direct business partner, or an indirect business partner; and how much influence the company has over the business partner that could (or did) cause or jointly cause the adverse impact.
[20] Articles 10(1) and 11(1).
[21] Article 3(1)(o).
[22] Articles 10(4): "As regards potential adverse impacts that could not be prevented or adequately mitigated by the appropriate measures… the company may seek contractual assurances from an indirect business partner, with a view to achieving compliance with the company's code of conduct or a prevention action plan." Article 11(5): "As regards actual adverse impacts that could not be brought to an end or the extent of which could not be adequately minimised by the appropriate measures … the company may seek contractual assurances from an indirect business partner, with a view to achieving compliance with the company's code of conduct or a corrective action plan."

unrealistic requirements (limiting measures to those that are "reasonably available to the company"), we must assume that companies that are not in-scope should have at least the same protection. As such, appropriateness should inform the due diligence expectations of in-scope companies vis-a-vis their own suppliers and business partners. Contractual due diligence obligations should therefore be formulated by taking suppliers' capacity into account, providing assistance, and making other adjustments, as necessary.

The dos and don'ts of due diligence-aligned contracting

The Directive, including the recitals, sets out key principles on what appropriate contracting looks like. The below provides an overview of the types of contracting practices that companies should avoid, and which they should pursue, to be in sync with the new EU regime:

1. **Don't employ risk-shifting contracts that simply transfer due diligence responsibilities to business partners and require perfect compliance. Instead, use contracts that share the responsibility for due diligence and facilitate on-going cooperation between the parties.**

Due diligence requires each actor in the chain to do their part to address adverse impacts and to take responsibility for their involvement in adverse impacts. Furthermore, HREDD is an obligation of means, not results. As such, it does not expect perfection. Thus, contracts that place obligations only on the supplier and that 'outlaw' imperfection by treating any deviation from perfect performance (e.g., compliance with a code of conduct) as a breach of contract are fundamentally out of sync with the CSDDD.

- **Avoid one-sided obligations for suppliers only:** The Directive clearly states that, as preventive and corrective measures, contracts must reflect the degree to which a company has jointly caused an impact.[23] A contract that only obliges the supplier (not the buyer) to uphold HRE standards is out of sync with this requirement because it allows buyers to contractually wash their hands of an adverse impact, even if they jointly caused (contributed) it.[24] Recitals 46 and 54 illustrate that the EU legislators share this understanding by clarifying that contractual clauses must be designed to ensure that responsibilities are *shared* appropriately between the parties, not simply imposed on business partners.[25] This is reinforced by Recital 66, which underlines that contracts should not be used to transfer the legal obligations of the Directive to business partners and the contract should clearly allocate tasks to both parties.[26]

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[23] Articles 10(1) and 11(1).
[24] The CSDDD addresses the responsibility of buying companies to avoid contributing to adverse impacts at the supplier level in Articles 10(1)(a) and 11(1)(a) and in Recitals 45 and 53. The issue also comes up specifically in relation to purchasing, distribution, and design practices, which are addressed in Articles 10(2)(d), 11(3)(e) and in Recitals 46, 47, 54, discussed in more detail below.
[25] Recitals 46 and 54 both contain similar (emphasised) language in this regard: "Contractual assurances should be designed to ensure that responsibilities are shared appropriately by the company and the business partners. The contractual assurances should be accompanied by appropriate measures to verify compliance. However, the company should only be obliged to seek the contractual assurances, as obtaining them may depend on the circumstances.").
[26] Recital 66, which deals with the guidance on model contract clauses to be developed by the European Commission, clarifies that "The guidance should aim to facilitate a clear allocation of tasks between contracting parties and ongoing cooperation, in a way that avoids the transfer of the obligations provided for in this Directive to a business partner and automatically rendering the contract void in case of a breach."

- **Avoid strict liability clauses that treat any imperfection in the supplier's performance as a breach of contract:** While one-sided contractual guarantees of perfection (usually imposed on the weaker, production-country supplier) are simple to draft and enforce, they are neither appropriate nor effective for HREDD purposes because they create incentives for suppliers -- who want to get and keep the contract -- to hide problems that arise in their (or their suppliers' and subcontractors') operations. Such incentives undermine the transparency, collaboration, and trust that are critical for the achievement of due diligence objectives.

  Strict compliance clauses that say something to the effect of, "The supplier shall comply with the code of conduct and any violation shall constitute a material breach of contract" can actually aggravate HRE risks, because they decrease the probability of them being addressed. If the contract says that the buyer can, even at the first sign of trouble, contractually sanction suppliers, immediately cancel an order, suspend payments, or terminate the relationship altogether, the business partner will be reluctant to disclose problems. This will make it harder for the in-scope company not only to identify adverse impacts in its due diligence (e.g., via questionnaires, audits, or supplier interviews), but also to design and implement measures capable of effectively addressing the impacts, as required by the CSDDD. Indeed, a critical shortcoming of strict liability clauses is that they leave little room either to prevent or to correct (and, by extension, remedy) adverse impacts, as required by the CSDDD. By creating incentives to hide impacts, instead of addressing them, strict liability clauses are counterproductive and cannot be considered effective. They are also not commensurate with the likelihood of impacts, which, in many (if not all) supply chains, cannot be completely eradicated. Impacts are likely, in other words, so obliging suppliers to meet a zero-impacts standard is not appropriate.

  A related reason why strict compliance clauses are not appropriate is because they are unrealistic: There is no such thing as a perfectly pristine supply chain that is free of HRE issues. This is why HREDD is an obligation of means rather than results. Thus, clauses that require perfection ask suppliers and business partners to make promises that they cannot keep and often place suppliers in breach of contract on day one. This goes against the CSDDD's approach to appropriateness, which, as mentioned above, instructs that due diligence measures must be "reasonably available" to the parties[27]-- the impossible is not a reasonably available solution.

- **Contractually commit the parties to share responsibility for addressing adverse impacts:** Because companies will be required to conduct due diligence in both their own business operations and in their chain of activities,[28] cooperation and transparency with business partners will be essential. Contractually, this demands a clear allocation of tasks that reflects the shared responsibility of both partners to collaborate in carrying out due diligence.[29] Contracts should be designed to support and establish a process for on-going cooperation to support the effectiveness of (all) due diligence measures. This means setting realistic

[27] Article 3(1)(o) ("'appropriate measures' means measures that are … reasonably available to the company, taking into account the circumstances of the specific case, including the nature and extent of the adverse impact and relevant risk factors").
[28] The CSDDD defines the chain of activities to include the upstream supply chain and a share of the downstream value chain limited to distribution, transport, and storage of goods.
[29] See the requirements of Recitals 46, 54, 66.

obligations for both parties that reflect their respective capacities to meet HRE-related expectations and objectives. Rather than committing contractually to achieving perfect results, the parties should make a joint commitment to carry out on-going HREDD in cooperation. And, if one of the parties is a small or medium-sized enterprise ("SME"), it may be more appropriate for them to commit to cooperating in the buyer's HREDD process, rather than setting up their own.

Contracts that transfer the entire responsibility for due diligence from in-scope companies to their business partners create a legal fiction that only the partner is responsible, ignoring that appropriateness requires due diligence measures to "take into account" the company's own level of involvement in the impact -- causing, jointly causing, or being directly linked.[30] The recitals therefore rightly state that such transfers are to be avoided.[31]

Sharing responsibilities appropriately also requires responsible purchasing behaviour and cost-sharing by in-scope companies, which means that the companies must assume responsibility for their contributions to negative impacts (for example, through their purchasing practices) and consider their supplier's knowledge, resources, and constraints. More on this just below.

2. **Don't ignore the role of in-scope companies' purchasing practices. Instead, include a contractual commitment to responsible purchasing practices from day one.**

The CSDDD requires that, where relevant to prevent and correct adverse impacts, companies must adjust their purchasing practices.[32] This aligns with the requirement that preventive and corrective measures should be designed to account for how the company's own behaviour (including purchasing practices) could contribute to potential, or has contributed to actual, adverse impacts.[33] Contracts that fail to address purchasing practices as a component of HREDD would likely fail to meet the CSDDD's appropriateness requirements.

- **Avoid incentivising adverse impacts via unfair commercial clauses:** The CSDDD clarifies that companies are responsible not only for adverse impacts they cause directly, but also for impacts they jointly cause ("contribute to" in UNGP terminology) through their own actions and omissions.[34] Jointly cause covers behaviours that incentivize adverse impacts,[35]

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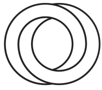
[30] Article 10(1).
[31] Recital 66: "The guidance should aim to facilitate a clear allocation of tasks between contracting parties and ongoing cooperation, in a way that avoids the transfer of the obligations provided for in this Directive to a business partner and automatically rendering the contract void in case of a breach."
[32] Article 10(2)(d) (Where relevant, companies are required to employ preventive measures, including, making "necessary modifications of, or improvements to, the company's own business plan, overall strategies and operations, including purchasing practices, design and distribution practices"). See Article 11(3)(e) for similar language with respect to corrective measures.
[33] Article 10(1)(a) and 11(1)(a) ("To determine the appropriate measures … due account shall be taken of: (a) whether the … adverse impact may be caused only by the company; whether it may be caused jointly by the company and a subsidiary or business partner, through acts or omissions; or whether it may be caused only by a company's business partner in the chain of activities."). Considering the company's own contributions to potential and actual adverse impacts matters for designing appropriate measures, since it is difficult to effectively address an issue without addressing root causes, such as poor purchasing practices.
[34] Article 10(1), 11(1), Recital 53.
[35] Recitals 53 and 58: ("Jointly causing the adverse impact is not limited to equal implication of the company and its subsidiary or business partner in the adverse impact, but should cover all cases of the company's acts or omissions,



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such as poor purchasing practices,[36] and, by extension, contracts that formalise such practices.

Companies will need to assess whether and how their purchasing practices are likely to create risks and to change them "where relevant."[37] The risks associated with purchasing practices vary between sectors and the power dynamics that characterise them, although they are known to be especially relevant in low-wage sectors with stark power imbalances between buyers and suppliers, such as agriculture, textiles, transport, cleaning, and construction.[38] Contracts that fail to include, for example, a price, lead times, technical and/or financial assistance, or contract durations that can support suppliers in upholding the relevant, industry and context-specific, HRE standards risk incentivizing adverse impacts. Companies should adapt their commercial clauses accordingly, starting with the riskiest product categories.

Most importantly, purchasing practices should be designed to "contribute to living wages and incomes for their suppliers."[39] This may, especially in low-wage sectors, require formulating price clauses that include a commitment to paying a living wage or income to the supplier's workers, as well as a process for calculating, ringfencing, and paying that price.[40] The effectiveness of these types of clauses would be enhanced by including a price escalation clause that would allow the price to increase in the event of an increase in other costs related to the contract, for example, an increase in the local minimum wage, input costs, or other production costs.

Irresponsible purchasing is probably the most typical case of "jointly causing" an adverse impact and therefore rightly highlighted in the CSDDD as something for companies to pay close attention to. One-sided contracts that ignore the buyer's responsibility to prevent (or correct) adverse impacts--even those they contribute to via their purchasing practices--will likely be viewed as inappropriate for a few reasons. First, they fail to take the company's level of involvement in adverse impacts into account, as required by the CSDDD.[41] Here again one-

causing the adverse impact in combination with the acts or omissions of subsidiaries or business partners, including where the company substantially facilitates or incentivises a business partner to cause an adverse impact, that is, excluding minor or trivial contributions.")

36 Recital 46 ("Where relevant, companies should adapt business plans, overall strategies and operations, including purchasing practices, and develop and use purchasing policies that contribute to living wages and incomes for their suppliers, and that do not encourage potential adverse impacts on human rights or the environment. To conduct their due diligence in an effective and efficient manner, companies should also make necessary modifications of, or improvements to, their design and distribution practices, to address adverse impacts arising both in the upstream part and the downstream part of their chains of activities, before and after the product has been made. Adopting and adapting such practices, as necessary, could be particularly relevant for the company to avoid an adverse impact in the first instance. Such measures could also be relevant to address adverse impacts that are jointly caused by the company and its business partners, for instance due to the deadlines or specifications imposed on them by the company. In addition, by better sharing the value along the chain of activities, responsible purchasing or distribution practices contribute to fighting against child labour, which often arises in countries or territories with high poverty levels.")

37 Articles 10(2)(d) and 11(3)(e) have similar language on this: "Companies shall be required to take the following appropriate measures, where relevant: (...) make necessary modifications of, or improvements to, the company's own business plan, overall strategies and operations, including purchasing practices, design and distribution practices."

38 Recital 47 specifically identifies only agriculture as a low-wage sector, but the others in this list are known to be both low-wage and high risk.

39 Recital 46: "Where relevant, companies should … use purchasing policies that contribute to living wages and incomes for their suppliers, and that do not encourage potential adverse impacts on human rights or the environment."

40 For guidance, see https://actonlivingwages.com/app/uploads/2021/04/ACT-Labour-Costing-Protocol.pdf.

41 Article 10(1)(a) and Article 11(1)(a).

sided contracts create a legal fiction where only the supplier is responsible for adverse impacts, which renders invisible the buyer's own contributions to the problem(s). This fiction allows companies to contract their way out of responsibility for adverse impacts, even when it is clear that they contributed to the impacts. Second, such contracts clearly fail to ensure that "responsibilities are shared appropriately"[42] as required by the CSDDD. Third, one-sided contracts undermine the effectiveness of the company's other due diligence measures: Only by including responsible purchasing commitments in the contracts will suppliers be able to rely on these commitments and have the security, stability, and the assurance *they* need to effectively participate in and support the in-scope company's due diligence process to prevent and address adverse impacts.

Moreover, without a contractual commitment by the buyer to engage in responsible purchasing, adverse impacts--even those directly attributable to irresponsible purchasing--could unfairly trigger additional supplier obligations, as the buyer could simply claim, using the contract, that (any and all) adverse impacts are the supplier's responsibility. This is why the CSDDD recitals that address contracts rightly emphasise the need for contracts to reflect clear tasks and responsibilities for both parties to address adverse impacts and the need to avoid using the contract to transfer due diligence obligations from in-scope companies to their business partners.[43]

- **Include a commitment by companies to engage in responsible purchasing as part of their HREDD obligations:** The CSDDD recognises that purchasing practices are a component of HREDD and that poor practices can undermine due diligence efforts. Contracts should be designed to reflect this by (a) identifying responsible purchasing practices as a due diligence obligation and (b) including commitments to specific purchasing practices that are likely to be relevant for preventing adverse impacts in the supply chain at issue (e.g., transparent forecasting, providing financial and technical assistance to implement HREDD, accepting due diligence questionnaires prepared for other business partners when possible).

- **Set commercial terms that can support effective HREDD:** Prices, contract lengths, delivery times, payment terms, and other commercial terms must be set taking into account the negative incentives they might create. This entails, for example, price escalation clauses that factor in rising minimum, living wages or incomes, or collective bargaining agreements and ring-fence labour costs. Additionally, companies can reward good HRE performance and incentivise continued performance, for example through contract renewals, additional investments (including to help improve access to finance) in the supplier, or higher order volumes. Such positive incentives will be especially relevant in high-risk and low-wage sectors.

3. **Include cost-sharing commitments in your contracts to ensure that HREDD-related costs are fairly distributed and that business partners, especially SMEs, are not overburdened:**

[42] Recitals 46 and 54.
[43] Recitals 46 and 54 ("Contractual assurances should be designed to ensure that responsibilities are shared appropriately by the company and the business partners"), and Recital 66 ("The guidance should aim to facilitate a clear allocation of tasks between contracting parties and ongoing cooperation, in a way that avoids the transfer of the obligations provided for in this Directive to a business partner and automatically rendering the contract void in case of a breach. The guidance should reflect the principle that the mere use of contractual assurances cannot, on its own, satisfy the due diligence standards provided for in this Directive.")

Contracts that simply transfer due diligence obligations and associated costs to business partners are inappropriate, especially if the partner in question lacks the capacity to meet such obligations. It cannot be assumed that all business partners are capable of establishing or implementing complex due diligence measures.[44] If the partner cannot reasonably be expected to perform an obligation, that obligation cannot be considered effective.

As an expression of the principle of proportionality, appropriateness protects in-scope companies from being overwhelmed by unrealistic or unduly burdensome requirements: Companies are expected to employ only those due diligence measures that are "reasonably available" to them.[45] It would be incoherent and in conflict with the principle of proportionality if in-scope companies could contractually require their suppliers to do more than they themselves are legally required to do.[46] Although the CSDDD expressly protects only SMEs from unrealistic requirements,[47] the appropriateness requirement, which applies throughout the Directive, provides strong support for extending that same protection to non-SME suppliers, as well. This extension seems justified, also to avoid an interpretation of the CSDDD that would lead in-scope companies to abandon their SME suppliers in favour of larger, non-SME suppliers.

Contractual HREDD requirements that create excessive burdens on suppliers (e.g., requiring small companies to establish full-fledged own HREDD systems and carry out comprehensive risk assessments, set up expansive grievance mechanisms, complete unreasonable numbers of due diligence questionnaires, obtain multiple certifications at their own cost, or subject themselves to unlimited audits) are likely to be viewed as inappropriate because they ignore the "reasonably available" requirement and fail to take the supplier's capacity into account. Moreover, the effectiveness of such requirements is questionable, since overwhelmed suppliers are less likely to implement the required measures in a satisfactory manner.

One-sided, risk-shifting contracts that pass all the responsibilities--and costs--associated with HREDD to suppliers, without considering the latter's capacity or the extent to which the buyer's own conduct may contribute to adverse impacts, will likely fall short of meeting the appropriateness requirement as articulated in the CSDDD because they fail "to ensure that

[44] Article 10(2)(e) and Article 11(3)(f), along with Recitals 46 and 54 ("Companies should also 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 of conduct or the prevention action plan would jeopardise the viability of the SME, the in-scope company must provide targeted and proportionate financial support, such as direct financing, low-interest loans, guarantees of continued sourcing, or assistance in securing financing.")
[45] Article 3(1)(o).
[46] The Recitals support the view, that it is important to not overwhelm suppliers for example in Recital 66 which states that the guidance on model contract clauses to be prepared by the European Commission under Article 18 should be formulated "in a way that avoids the transfer of the obligations provided for in this Directive to a business partner and automatically rendering the contract void in case of a breach."
[47] Article 10(2)(e) and Article 11(3)(f), along with Recitals 46 and 54 ("Companies shall be required to take the following appropriate measures, where relevant: (...) provide targeted and proportionate support to 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 (...).")

responsibilities are shared appropriately by the company and the business partners."[48] Such contracts further fail to "facilitate a clear allocation of tasks between contracting parties and ongoing cooperation, in a way that avoids the transfer of the obligations provided for in this Directive."[49]

To be appropriate, contracts should set out joint and balanced HREDD obligations that reflect the need to support suppliers, especially those with limited resources and capacity, in their efforts to effectively address (prevent, mitigate, and remedy, as appropriate) adverse impacts:

- **Avoid supplier overwhelm:** To avoid overwhelming SME suppliers with HREDD obligations, SMEs should be given a contractual choice: Establish and maintain their own due diligence process or participate in the buyer's due diligence process, noting that the latter option may be less onerous. This "opt out" provision could also be made available to larger business partners that are not in-scope for the CSDDD.

- **Share HREDD-related costs:** Contracts with SMEs should also commit the parties to share the costs associated with implementing certain due diligence measures, as appropriate, as well as the costs associated with verifying the implementation of due diligence measures.[50] Without these types of cost-sharing commitments, contracts would be out of sync with the requirement that the terms for SMEs be "fair, reasonable and non-discriminatory" and that in-scope companies must provide support to SMEs in implementing due diligence measures.[51] Again, however, a reasonable interpretation of the CSDDD as a whole strongly indicates that cost-sharing will also be appropriate in contracts with (perhaps not all) non-SME partners. In particular, in the event of an adverse impact that requires the preparation and implementation of a preventive action plan (for a potential adverse impact) or a corrective action plan (for an actual adverse impact), the parties must share the associated costs in proportion to each party's contribution to the adverse impact.[52]

    - This interpretation is also in line with the non-discrimination principle for SMEs:[53] If SMEs are viewed as needing more support from in-scope companies, financial or otherwise, they could well become less attractive as business partners, which would undermine the non-discrimination principle.

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[48] Recitals 46 and 54.
[49] Recital 66.
[50] Articles 10(5) and 11(6) ("Where measures to verify compliance are carried out in relation to SMEs, the company shall bear the cost of the independent third-party verification. Where the SME requests to pay at least a part of the cost of the independent third-party verification, or in agreement with the company, that SME may share the results of such verification with other companies.")
[51] Articles 10(5) and 11(6) ("When contractual assurances are obtained from, or a contract is entered into with, an SME, the terms used shall be fair, reasonable and non-discriminatory"); 10(2)(e) and 11(3)(f) ("Companies shall be required to take the following appropriate measures, where relevant: (...) provide targeted and proportionate support to 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 (...).").
[52] This is a logical extension of the principle stated in Articles 10(1) and 11(1) that preventive and corrective measures must be designed to address both parties' contributions to the impact.
[53] Articles 10(5) and 11(6).

- ○ Joint commitments to cost-share when appropriate should be included in the contract at the outset of the relationship. This is the most pragmatic approach as it operationalises on-going cooperation with business partners on implementing and paying for due diligence from day one.

4. **Include a contractual commitment to remediate (cure, correct) adverse impacts that may arise and prioritise remediation ahead of order cancelation or termination. Include responsible exit commitments in the contract. Do not include immediate or zero-tolerance termination rights.**

The CSDDD clearly states that disengagement for HREDD-related reasons should only be pursued as a last resort and only in case of *severe* adverse impacts where preventive or corrective action is unrealistic, meaning "there is no reasonable expectation that those efforts would succeed," or where such action has (definitively) failed.[54] Furthermore, a company that is deciding whether to stay or go must do so responsibly, weighing whether the adverse impacts created by exiting "can be reasonably expected to be manifestly more severe than the adverse impact that could not be prevented or adequately mitigated."[55] In such a case, the company may, at its discretion, continue the relationship. This language can fairly be read as creating an expectation that, if the company elects not to continue the relationship and disengage, it will first do what it can, employing the measures reasonably available to it, to minimise the negative impacts of its disengagement.

Disengagement is often not an appropriate measure for addressing (potential or actual) adverse impacts, as it does little, if anything, to effectively prevent, minimise, correct, or remedy such impacts. Rather, it simply works to remove ("de-risk") such impacts from the chain of activities. This approach will often be inadequate under the CSDDD. That being said, in some cases, particularly where the supplier is clearly not willing to improve or cooperate, or where remaining in the contract (beyond a reasonable period of time) would cause additional severe impacts, severing the relationship may be the most effective way to proceed.

- **Don't set negative incentives via contractual suspension and termination rights**. Contracts that allow for immediate suspension or termination in the event of adverse impacts are not appropriate because they are ineffective. They are ineffective because they reduce the

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[54] Article 10(6) and 11(7), along with Recitals 50 and 57 (for potential adverse impacts that could not be prevented or adequately mitigated and for actual adverse impacts that could not be brought to an end or the impact of which could not be minimised by due diligence measures, "the company shall, as a last resort, be required to refrain from entering into new or extending existing relations with a business partner in connection with which, or in the chain of activities of which, the impact has arisen." To address adverse impacts, whether potential or actual, the company must adopt and implement an "enhanced" prevention or corrective action plan, with "a specific and appropriate timeline for the adoption and implementation of all actions therein, during which the company may also seek alternative business partners." Termination should only be pursued "if there is no reasonable expectation that those efforts would succeed" or, for potential adverse impacts, "if the implementation of the enhanced prevention action plan has failed to prevent or mitigate the adverse impact" and, for actual adverse impacts, "if the implementation of the enhanced corrective action plan fails to bring to an end or minimise the extent of the adverse impact." Even then, termination should only be "with respect to the activities concerned" and only if the "adverse impact is severe.").

[55] Article 10(6)(b) and 11(7)(b) ("Prior to temporarily suspending or terminating a business relationship, the company shall assess whether the adverse impacts from 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 for such decision.")

likelihood that problems will be identified, disclosed, and, consequently, addressed. Faced with the possibility of immediate suspension or termination, suppliers, particularly the commercially weaker ones, will be strongly incentivized to hide problems instead of (immediately) bringing them to their buyer's attention so that the parties can--swiftly and collaboratively--address the impacts in question. This is clearly ineffective.

  - Furthermore, strict termination rights fail to meet the requirement that preventive and corrective measures must account for the buyer's own contributions to adverse impacts. In other words, if a buyer contributes to or jointly causes an impact through, for example, their purchasing practices, that contribution would be completely erased via an immediate termination clause that can only be invoked by the buyer.

- **Contractually prioritise remediation (cure) ahead of suspension and termination, clarifying that termination is a last resort.** Contracts should include a clear procedure for remediating adverse impacts that may end in termination, but only as a last resort. The occurrence of an adverse impact should trigger a procedure in which the parties work together and cooperate to address the impact in question. The parties should contractually commit to preparing, implementing, and paying for (a) a preventive action plan to address potential adverse impacts or (b) a corrective action plan to address actual adverse impacts, in proportion to their respective contributions to the impact(s).[56]

  - The buyer should commit to providing assistance, guidance, and other support to facilitate the remediation process, where and as needed, regardless of whether they jointly caused the impact.

  - Including a clear right to cure with a clear process for corrective action lessens the incentive for suppliers to hide problems because they will know, with contractual certainty, that there will be an opportunity to fix the problem in collaboration with their buyer(s).

  - Only when it becomes clear that corrective efforts will likely fail (or have already failed) should contractual sanctions be exercised, starting with suspension and moving to termination only if there is no reasonable expectation of improvement.

  - Although it should only be invoked as a last resort, the right to terminate should be preserved in the contract as a preventive measure: It sends a strong signal that the company is serious about HREDD and may be effective for deterring misconduct by the counterparty.

- **Include a joint commitment to exit responsibly by addressing the adverse impacts caused by the exercise of termination rights**. The termination of a contract can lead to adverse impacts, for example, by affecting the capacity of the supplier to pay adequate living wages to their workers or to retain their workers. If the terminating party is in-scope for the Directive, it must take measures to address these impacts as part of its due diligence

[56] Recitals 50 and 57.

obligations.[57] Clarifying this expectation in the contract would better inform--and may even change--the decision to terminate. Measures for mitigating the impacts of termination are varied, for example, helping workers find new jobs, providing training to increase the skills of affected workers, and contributing to a severance fund. Such measures would limit the adverse impacts generated by termination, which must not be unreasonable in comparison with the adverse impacts that led to termination.[58]

- **Include a joint commitment to exit responsibly by providing reasonable notice to business partners when suspending or terminating a business relationship and to pay for outstanding invoices incurred prior to the termination date**.[59] This will allow the partner to prepare for disengagement and to do their part to mitigate the impacts of termination, for example, by finding new customers (right to work). It will also help prevent the problem of workers not being paid for work they had already done (wage theft), as happened on a dramatic scale when buyers cancelled orders (even completely manufactured and shipped) during the COVID-19 lockdown.[60]

Conclusion & Summary Chart

The CSDDD's requirements in relation to contracts may well bring about a paradigm shift in how commercial contracts are designed, performed, and terminated. Contracts and codes of conduct will continue to play a critically important role in companies' implementation of due diligence within their supply chains, but companies will have to fundamentally change how they design these instruments because traditional risk-shifting approaches do not meet the CSDDD appropriateness requirement. Companies should prepare for these new requirements and start reviewing and upgrading their contracts and codes accordingly. In making the transition toward due diligence-aligned contracting, companies would be well advised to integrate the shared-responsibility principles that are enshrined in the UNGPs and the OECD Guidelines, which serve as the foundation for the Directive.[61]

The Responsible Contracting Project (RCP) website provides an open-access toolkit with various examples of model clauses and codes of conduct that companies can select and adapt to move toward due diligence-aligned contracts. The European Model Clauses (EMCs), which are currently being developed by a working group of European legal practitioners, academics, and business and human rights experts, aim to provide a template for due diligence-aligned contracting that tracks the CSDDD

[57] Article 10(6)(b) and 11(7)(b) ("Prior to temporarily suspending or terminating a business relationship, the company shall assess whether the adverse impacts from doing so can be reasonably expected to be manifestly more severe than the adverse impact that could not be prevented or adequately mitigated.")
[58] Recitals 50 and 57.
[59] Article 10(6) and Article 11(7).
[60] Jeff Vogt, Miriam Saage-Maaß, Ben Vanpeperstraete, and Ben Hensler, Farce Majeure: How Global Apparel Brands Are Using The COVID-19 Pandemic to Stiff Suppliers and Abandon Workers, European Center for Constitutional and Human Rights (ECCHR), Worker Rights Consortium (WRC), and ILAW (2020); John Sherman III, Irresponsible Exit: Exercising Force Majeure Provisions in Procurement Contracts, Business & Human Rights Journal (2020).
[61] For an analysis of the German Supply Chain Act yielding a similar conclusion, see, Sarah Dadush, Daniel Schönfelder, and Bettina Braun, Complying with Mandatory Human Rights Due Diligence Legislation through Shared-Responsibility Contracting: The Example of Germany's Supply Chain Act (LkSG), Chapter 14 in Contracts for Responsible and Sustainable Supply Chains: Model Contract Clauses, Legal Analysis, and Practical Perspectives (Susan Maslow & David Snyder eds., ABA Business Law Section, 2023). See also, Michaela Streibelt and Daniel Schönfelder, Effective and Appropriate HREDD Requires a Shared Responsibility Approach, Responsible Contracting & Purchasing, NOVA Law Blog on Business, Human Rights, and the Environment (December 2023).

requirements with respect to contracts, including those identified in this policy brief. A Zero Draft of the EMCs will be published for consultation in July 2024 and the consultations will be coordinated by RCP on behalf of the working group. You can visit the RCP website for more information.

Please find a summary of the Dos and Don'ts of CSDDD-aligned contracting on the next page.

Disclaimer: Nothing contained in this Policy Brief is intended, nor should it be considered, as the rendering of legal advice. This Policy Brief is intended for educational and informational purposes only and adopting the recommendations herein does not guarantee full compliance with the CSDDD.

Summary Chart: The dos and don'ts of CSDDD-aligned contracting

Dos	Don'ts
Design contracts that share the responsibility for due diligence	Use contracts simply to transfer due diligence responsibilities to business partners
Jointly commit to cooperate to address adverse impacts in an on-going, risk-based, and dynamic fashion as this incentivises more trust and transparency between the parties	Use contracts to establish one-sided (supplier-only) obligations and strict liability approaches that treat any imperfection as a breach, which incentivises partners to hide problems
Commit to responsible purchasing practices from day one as these can help prevent or mitigate adverse impacts. Where possible, commit the seller to do the same with its sellers	Ignore the role of companies' purchasing practices as these can contribute to (jointly cause) adverse impacts
Commit to fair commercial terms that can support effective HREDD	Use contracts to formalise unfair commercial terms that can aggravate adverse impacts
Ensure that due diligence obligations and related costs are fairly distributed in the contract, based on the companies' respective capacities and resources. Especially for SMEs, ensure that business partners have the capacities and support they need to meet HREDD requirements	Overwhelm suppliers with unreasonable due diligence expectations, including expectations that they lack the capacity to meet and costs that they lack the resources to afford
Jointly commit to prioritising remediation or corrective action ahead of suspension and termination, and clarify that contract termination is a last resort	Aggravate adverse impacts through the use of immediate (or too-quick) or zero-tolerance termination rights
Commit to responsibly exiting the contract by giving reasonable notice to the counterparty and taking measures to identify and address adverse impacts caused by termination	Aggravate adverse impacts by exercising termination rights irresponsibly