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Trilogue agreement on the proposal for a Corporate Sustainability Due Diligence Directive (CSDDD) | Position of the German Federal Ministry of Justice

Dear Sir/Madam,
Esteemed colleagues,

After over half a year of intense debate, a provisional trilogue agreement was reached on the proposal for an EU Corporate Sustainability Due Diligence Directive (CSDDD). After careful consideration of its stance on this agreement, the German Federal Ministry of Justice has concluded that it is unable to endorse it. This will result in an abstention on Germany's part.

I am aware that this is a topic of great importance to you too, and that you were deeply involved in the debate; I would therefore like to explain this decision from the perspective of my Ministry.

The Federal Ministry of Justice supports the proposed directive's goal of enhancing protection for human rights and the environment in the supply chains of European companies. Nevertheless, an important consideration for us in the negotiations was ensuring that the resulting instrument:

- leads to actual improvements in terms of human rights and environmental concerns,
- creates a level playing field in Europe, and
- takes into account the early experience gained from application of the German Supply Chain Act (*Lieferkettensorgfaltspflichtengesetz*, LkSG) – in particular with regard to the avoidance of bureaucratic burdens.

Our negotiation strategy was to seek alignment of the outcome of the negotiations with these goals throughout the negotiation process. At the same time, we were aware that at the end of this process, a rational assessment of the result would depend on an overall appraisal of the outcome in relation to these goals.

Compared to what some participants in the trilogue negotiations had hoped for, significant progress towards the above-mentioned goals was in fact made. We would like to emphatically highlight and applaud these achievements. Nevertheless, it is the view of my Ministry that the trilogue agreement objectively fails to meet the requirements for a satisfactory solution. We would like to illustrate these shortcomings by way of the following examples:

- The trilogue agreement would impose considerable civil liability on companies for any breaches of obligations in the supply chain. The Federal Ministry of Justice has striven – in certain respects with notable success – to achieve a more practically-oriented liability regime than those contained in many of the drafts discussed during the negotiation process. For instance, liability is limited to breaches of provisions that have the effect of protecting third parties.

  Furthermore, the option of sharing audits and joint compliance with due diligence obligations in the context of industry initiatives was introduced. Nevertheless, the liability rules represent an additional burden compared to the German Supply Chain Act, which does not comprise liability rules, and would place additional strain on the affected companies – in particular as a result of the proposed rules on e.g. additions to the annexes, disclosure of evidence and limitation periods.

- With regard to the environment, the trilogue agreement departs from the established approach of specifying environmental risks in detailed, industry-specific lists, thereby ensuring the manageability and predictability of due diligence obligations for companies. A hidden general clause under environmental law results in extensive corporate responsibility for environmental damage, regardless of its concrete impact on people.

- Moreover, the scope of the draft directive is extremely wide, and far more companies would be affected than is the case under German law as it currently stands, for example. The construction sector would be classified as a “risk sector”. In a sector that has already been hit hard by a rise in rates of construction interest, the directive’s stricter audit and due diligence requirements could pose an indirect threat to the survival of small and medium-sized enterprises in particular. It is our impression that many businesses simply do not have the necessary human and financial resources. It is to be feared that the directive would result in even less construction activity in future. Not least in light of the current housing shortage in many parts of Europe, that would be disastrous.

- A further increase in liability risks would arise from the very broad conception of supply chain that underpins the draft directive: it encompasses all downstream activities and, under certain circumstances, even product disposal. The draft does not employ the very sensible distinction drawn in the German Supply Chain Act between direct and indirect suppliers.

- Just what obligations would in future involve liability for companies is also wholly unclear, as it has not been possible to delimit, clearly and with legal certainty, the power of the EU Commission to expand the range of obligations on companies by adopting delegated acts. In the view of my ministry, that power would only have been acceptable had there been a guarantee that it would be limited to obligations that were feasible and workable in business terms, and that Member States would have sufficient opportunity to contribute prior to a Commission decision. That, however, is not the case.

- Alongside the civil liability risk, there is also the risk of administrative penalties: the trilogue agreement provides for generally mandatory, turnover-based pecuniary penalties that are not limited to cases of serious breaches, and for the maximum limit for those penalties to be no less than 5% of a company's turnover. Such a rule appears disproportionate as there is no clear exception in the regulatory text that would allow, for example, the turnover-based calculation of pecuniary penalties to be waived if the degree of wrongdoing is nowhere near as high as in the case of serious misconduct. It is not clear either why such a strict rule is required alongside civil liability to ensure the appropriate and effective enforcement of due diligence requirements.

- While well-intentioned, the relaxation of due diligence requirements for specific cases would appear problematic from a competition policy standpoint. For example, risk assessments are to take account of whether a company in the supply chain is itself subject to the directive. That is, however, generally the case for large companies. Companies could therefore feel it necessary on risk management grounds to turn increasingly to such large companies for their supply needs.

  Large companies would thus gain a competitive advantage over small and medium-size enterprises, and we would potentially see market concentration by regulation.

- Furthermore, our companies are likely to face significant additional burdens in terms of financial costs, human resources and bureaucracy. For example, larger companies would have to draw up a plan – including specific emission reduction targets – to ensure that their company strategy is compatible with the Paris Agreement (known as a "climate transition plan").

They would also have to provide financial incentives to ensure that management and supervisory bodies comply with the climate transition plan. The latter proposal is incompatible with the role of the supervisory bodies and constitutes a serious interference in corporate governance, particularly as it may also affect partnerships due to the Directive's neutrality on legal structures. The costs and benefits of these measures are disproportionate.

- Ultimately, the agreement not only violates the criteria of fair competition and low bureaucracy, it also threatens to make the situation worse from a human rights and environmental perspective. Internationally, many European companies are seen as investors and buyers with a particular sensitivity towards human rights and environmental issues. Put simply, this is what European consumers expect of them. If European companies find themselves unable to manage their liability risks properly in the future and, as a result, increasingly withdraw from international supply arrangements and investment activities in emerging and developing countries, the damage may well be twofold: with this type of "onshoring", the benefits of the international division of labour will be lost. Moreover, these companies are likely to be replaced by other companies, such as those from China, whose human rights and environmental credentials will certainly not improve the situation in the countries concerned.

At least since Russia's attack on Ukraine, it can no longer be denied that the geopolitical framework has changed. Diversification of supply chains (de-risking) is unavoidable.

We need greater connectivity, not more unilateralism, in our economic relations. Europe has to find its place in the ongoing competition between the US and Chinese systems, and it needs a strong, competitive economy in order to hold its own on the world stage. We cannot and must not sacrifice the protection of human rights and environmental responsibility in pursuit of these goals. On the contrary: it is precisely these values that we as the EU stand for. And our companies should be ambassadors of these values, too. But in the fight for our values, we in the EU also need a new sense of realism. We must not make the mistake of shackling ourselves with bureaucratic regulations, because that would be no help to anyone.

Yours faithfully,