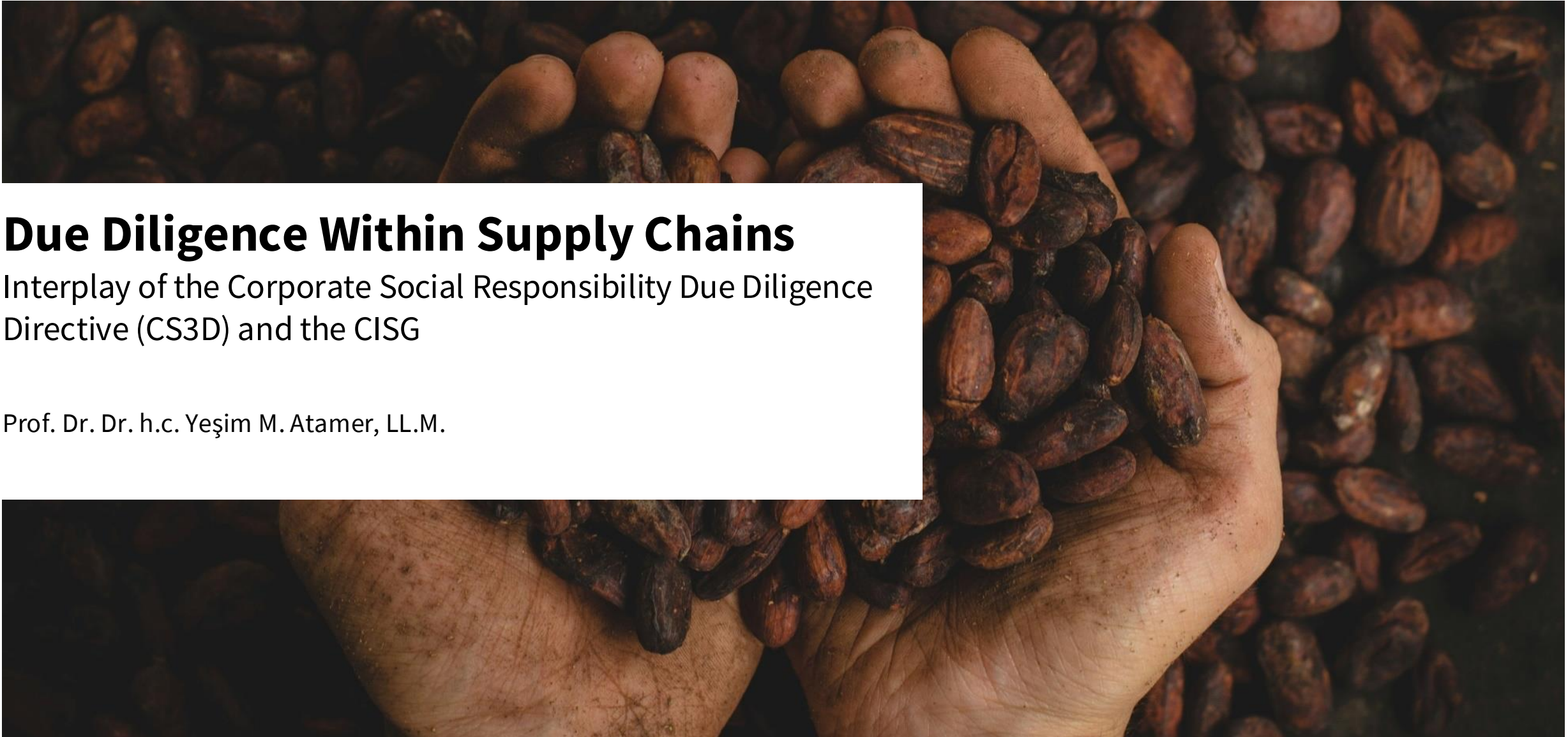




# Due Diligence Within Supply Chains

Interplay of the Corporate Social Responsibility Due Diligence Directive (CS3D) and the CISG

Prof. Dr. Dr. h.c. Yeşim M. Atamer, LL.M.





## Content

- Introduction – The Problem
- EU-CS3D
- Interplay of the EU-CS3D and the CISG
- Conclusion

# Introduction - The Problem

## *Nestlé USA, Inc. v. Doe (2021)*

- Damages claim of prior child slaves against Nestlé USA and Cargill under the Alien Tort Statute
- Arguments:
  - ✓ They purchased cocoa from Ivory Coast cocoa farms that used child labour;
  - ✓ Their conduct aided and abetted forced labour by providing training, fertilizer, tools, and cash to overseas farms;
  - ✓ They had economic leverage over the farms but failed to exercise it to eliminate child slavery.
  - ✓ They made all major operational decisions from within the USA.
- Claim was dismissed because “*all of the alleged conduct occurred overseas in this suit.*” The only domestic conduct alleged was “*general corporate activity*” in the USA .
  - ➡ ATS does not have extraterritorial application [see also *Kiobel v. Royal Dutch Petroleum Co. (2013)*]

The New York Times

## ***Supreme Court Limits Human Rights Suits Against Corporations***

Six citizens of Mali had sued Nestlé USA and Cargill, accusing the companies of profiting from child slavery on Ivory Coast cocoa farms.

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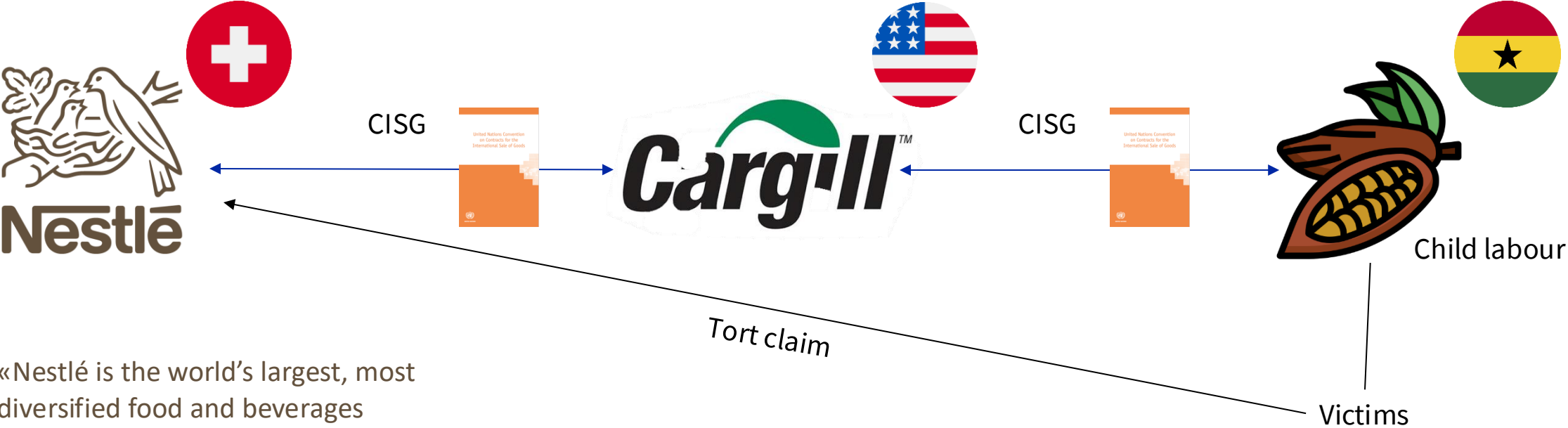


The decision by the Supreme Court on Thursday was the latest ruling to impose strict limits on lawsuits brought in federal court based on human rights abuses abroad. Stefani Reynolds for The New York Times



# Introduction - The Case

(adapted for present purposes)



«Nestlé is the world’s largest, most diversified food and beverages company. We have a unique global footprint and sell our products in 188 countries worldwide.»

Icons: Nestlé, Cargill and flaticon.com



## **EU Corporate Sustainability Due Diligence Directive (CS3D)**

# CS3D: Overview

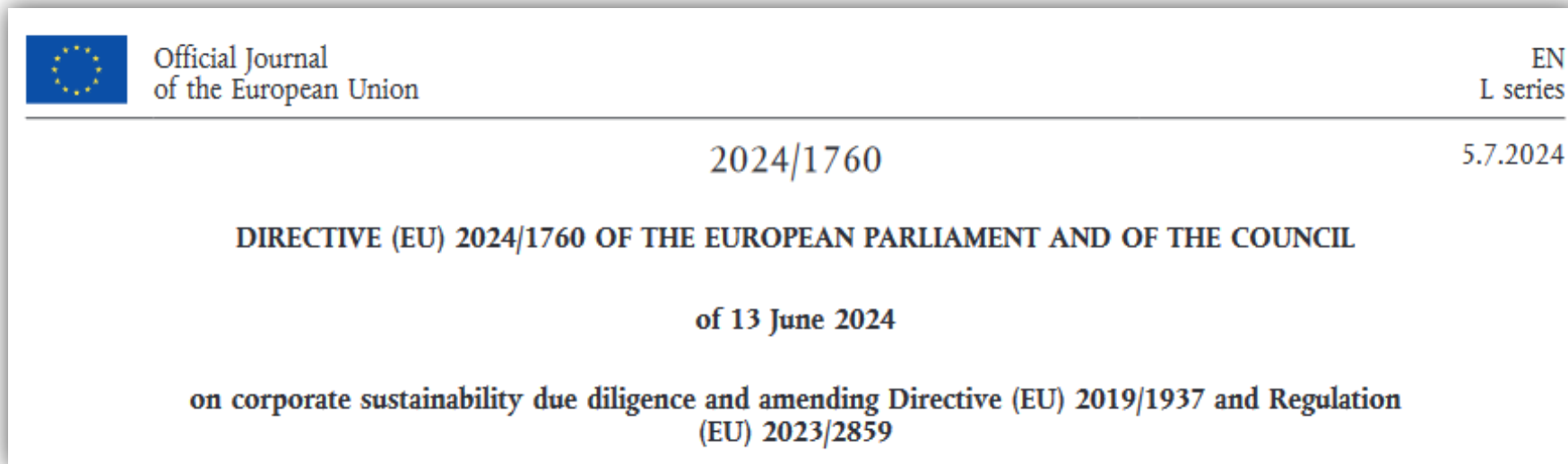
**Who?** Companies (EU and Non-EU); thresholds based on annual turnover and employees

**What?** Preventing actual and potential human rights and environmental adverse impacts

**Where?** Own operations, operations of their subsidiaries, and operations carried out by their business partners in the ‘chain of activities’

**How?** Substantive, risk-based human rights and environmental due diligence

**When?** Transposition by 26 July 2026; gradual application starting on 26 July 2027, full force on 26 July 2029 (Art. 37 CS3D)



# CS3D: Personal scope of application (Who?)

## Companies

- Governed by the law of a MS: all types of companies in which shareholders' liability is limited to their capital contributions
- Governed by the law of a third country: comparable legal entities
- Certain regulated financial undertakings

## Thresholds

Type of companies	Turnover		Employees
Formed in accordance with legislation of a Member State !	Worldwide turnover EUR 450 Mio + (consolidated if parent of group)		1000+ (consolidated if parent of group)
Formed in accordance with the legislation of a third country	EU turnover EUR 450 Mio + (consolidated if parent of group)		-
Franchising or licensing agreements	Royalties EUR 22.5 Mio + (Worldwide/EU)	Turnover EUR 80 Mio + (Worldwide/EU)	-

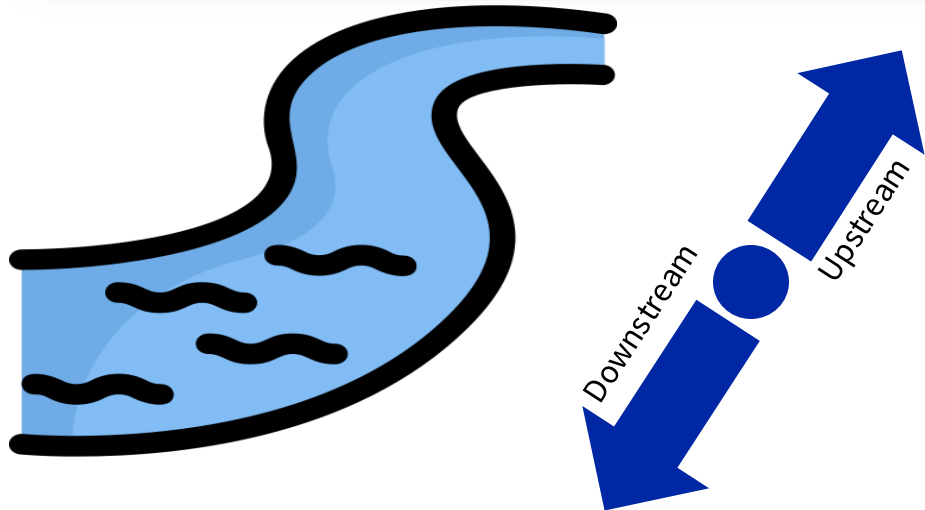
➡ Third country can be sued in the EU: *Extraterritorial direct effect*

➡ *Extraterritorial reach indirectly reinforced through contract governance*

# CS3D: Responsibility for business partners within the chain of activities (Where?)

(Relevant definitions contained in Art. 3(1) CS3D)

- (f) 'business partner' means an **entity**:
- (i) with which the company has a commercial agreement related to the operations, products or services of the company or to which the company provides services pursuant to point (g) **direct business partner**; or
  - (ii) which is not a direct business partner but which performs business operations related to the operations, products or services of the company **indirect business partner**;



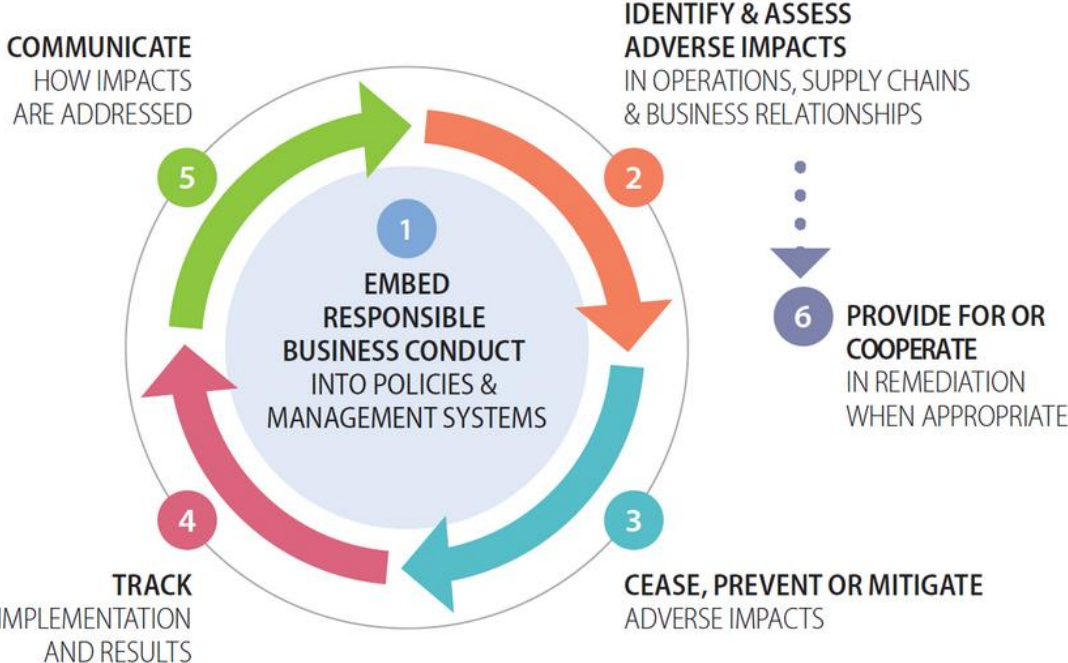
(g) 'chain of activities' means:

- (i) activities of a company's **upstream business partners** 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; and
- (ii) activities of a company's **downstream business partners** related to the distribution, transport and storage of a product of that company, where the business partners carry out those activities for the company or on behalf of the company, and excluding the distribution, transport and storage of a product that is subject to export controls under Regulation (EU) 2021/821 or to the export controls relating to weapons, munitions or war materials, once the export of the product is authorised;

*Upstream activity must be related to production of goods: mere resellers are (in principle) excluded*



# CS3D: Due diligence obligations



Source of left graphic: OECD

- 1** • Art. 7 CS3D: Integrating due diligence into company policies and risk management systems
- 2** • Art. 8 CS3D: Identifying and assessing actual and potential adverse impacts  
• Art. 9 CS3D: Prioritisation of identified actual and potential adverse impacts
- 3** • Art. 10 CS3D: Preventing potential adverse impacts  
• Art. 11 CS3D: Bringing actual adverse impacts to an end
- 4** • Art. 15 CS3D: Monitoring
- 5** • Art. 16 CS3D: Communicating
- 6** • Art. 12 CS3D: Remediation of actual adverse impacts  
• Art. 13 CS3D: Meaningful engagement with stakeholders  
• Art. 14 CS3D: Notification mechanism and complaints procedure

# CS3D: Contract governance

## Article 10

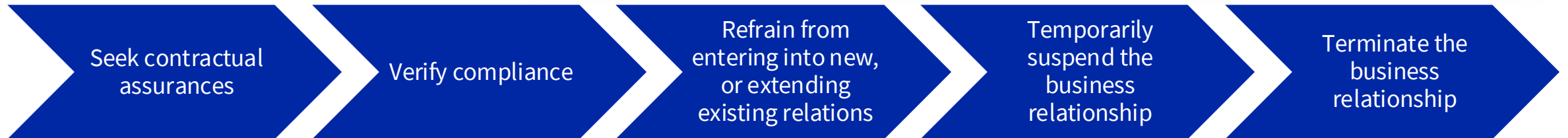
### Preventing potential adverse impacts

1. Member States shall ensure that companies take appropriate measures to prevent, or where prevention is not possible or not immediately possible, adequately mitigate, potential adverse impacts that have been, or should have been, identified pursuant to Article 8, in accordance with Article 9 and with this Article.

## Article 11

### Bringing actual adverse impacts to an end

1. Member States shall ensure that companies take appropriate measures to bring actual adverse impacts that have been, or should have been, identified pursuant to Article 8 to an end, in accordance with Article 9 and with this Article.



# CS3D: Contract governance

New contractual relations	Existing contractual relations (not exempted)
<i>Integrating Due Diligence Obligations into the Contract</i>	
<ul style="list-style-type: none"> <li>• Assurance (i.e. commitments) of compliance with following documents:               <ul style="list-style-type: none"> <li>✓ Code of Conduct</li> <li>✓ If necessary: prevention / corrective action plan</li> </ul> </li> <li>• Seek (not actually obtain)</li> <li>• From direct (and if necessary) indirect business partners</li> <li>• Require direct business partners to pass on</li> <li>• Terms vis-à-vis SME: FRAND</li> </ul>	<ul style="list-style-type: none"> <li>• Renegotiate, esp. long-term contracts</li> <li>• Make use of modification rights (if contractually agreed)</li> <li>• Suspend performance</li> <li>• Refuse to extend the contract</li> <li>• Terminate the contract (ultima ratio)</li> </ul>
<i>Ensuring Compliance</i>	
<ul style="list-style-type: none"> <li>• Monitor performance</li> <li>• Establish complaint notification system               <ul style="list-style-type: none"> <li>• Mitigate risks</li> <li>• Suspend the contract (if possible)</li> <li>• Terminate the contract (if possible)</li> </ul> </li> </ul>	

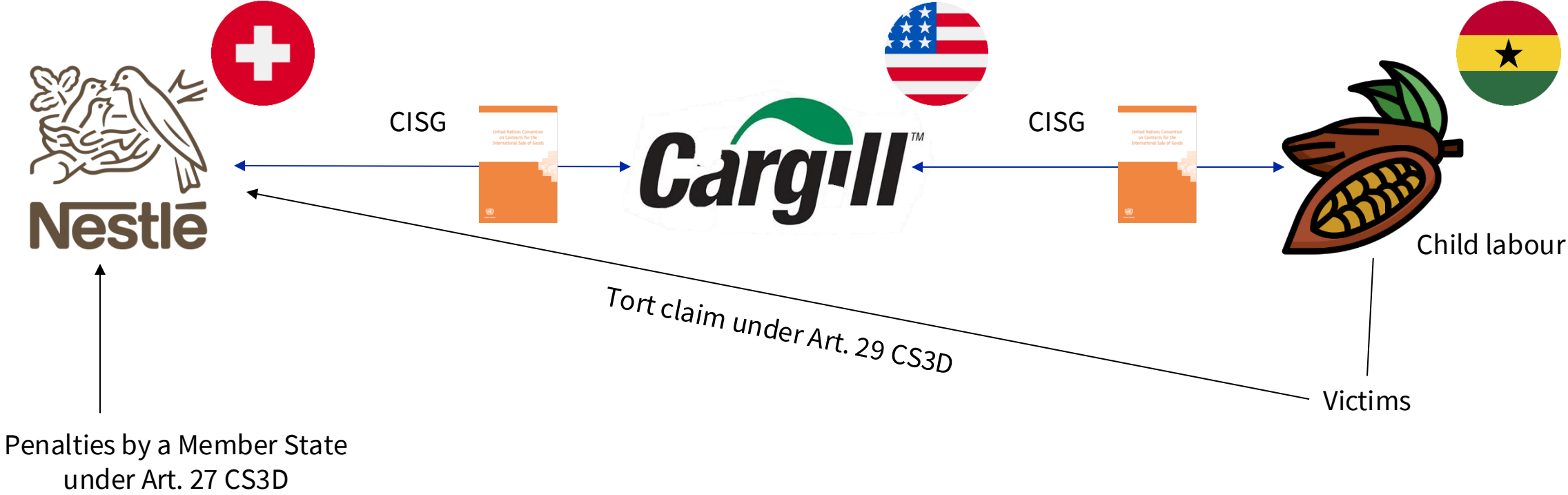


## Interplay of the EU-CS3D and the CISG



# The Case

(adapted for present purposes)

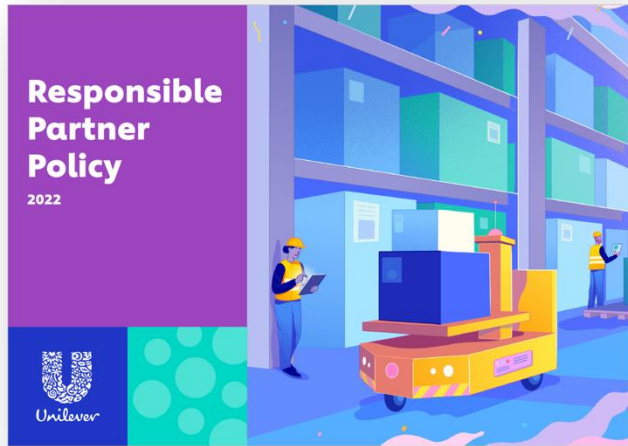


Icons: Nestlé, Gargill and flaticon.com

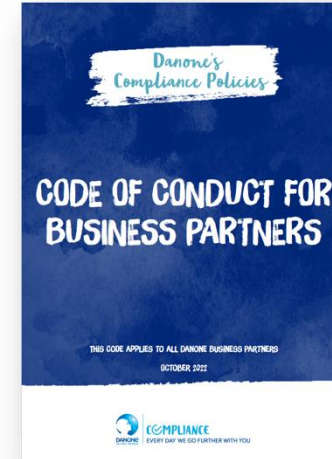
# CS3D & CISG: Getting assurances into the contract

## New contracts

- Detailed code of conducts
- Art. 18 CS3D: Commission, in consultation with Member States and stakeholders, shall adopt guidance about **voluntary model contractual clauses**.



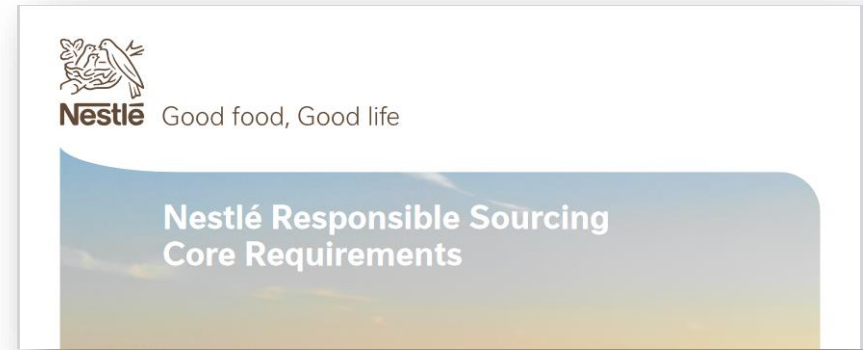
Images: Danone and Unilever



## Existing long-term contracts

- Many contracts already include codes of conduct
- The parties might have stipulated for a right to unilaterally amend existing contract / code of conduct
- Change of circumstances? Renegotiation? Adaptation?

# CS3D & CISG: Nature of new obligations



- On the side of the producer/seller of e.g. raw material:

- ✓ Dual nature of the contractual assurances

- Failure to adhere to sustainable production processes may render the goods non-conforming (Art. 35 CISG etc.)
- Failure to adhere to contractual assurances is also a breach of **ancillary (continuous) obligations** e.g. to avoid child labour, environmental negative effects etc.

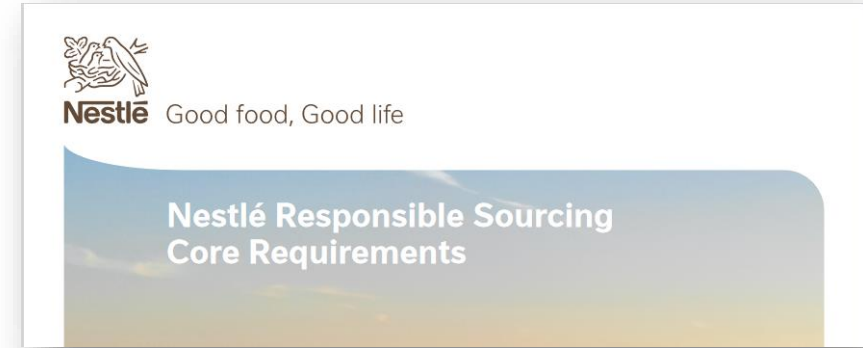
- ✓ Ancillary contractual obligation under Art. 45(1) CISG

- Agreement on what due diligence steps need to be taken on a continuous basis
- Breach irrespective of (and even prior to) delivery of goods
- Due diligence is forward-looking: Aims at preventing potential impacts and eliminates actual impacts
- Consequence: no product-centred remedies available (e.g. price reduction); no notification under Art. 39 CISG is necessary

- ✓ Importance of an Art. 35 CISG analysis:

- If the remedy requested is product-centred (i.e. substitute delivery, price reduction or damages for loss of profit etc.)
- Consequence: notification under Art. 39 CISG necessary

# CS3D & CISG: Nature of new obligations



- On the side of the buyer of e.g. raw materials?
  - ✓ Due diligence obligations on the side of the buyer should be included into the contract;
  - ✓ Continuous **ancillary obligations** of e.g. *engaging with a business partner about the company's expectations with regard to preventing and mitigating potential adverse impacts, or providing or enabling access to capacity-building, guidance, administrative and financial support such as loans or financing, while taking into consideration the resources, knowledge and constraints of the business partner* (Art. 10 (3) CS3D).



# CS3D & CISG: Ensure compliance

## Requirements of the CS3D

- Independent third-party certification (i.e. through multi-stakeholder initiatives):
  - ✓ Company shall bear (part of the) costs of certification for SME.

## Other possible stipulations

- visits to factories without prior warning
- penalty clauses
- right to suspend or terminate the contract

## Remedies under the CISG

- Require performance of cooperation duties (Art. 46(1) CISG)
- Suspend own performance (Art. 71 CISG and general principle according to Art. 7 (2) CISG)
- Avoid the contract



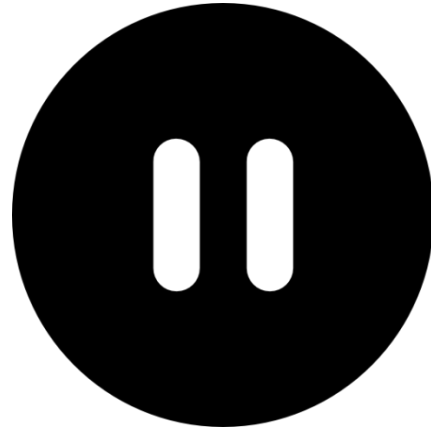
Icon: flaticon.com

# CS3D & CISG: Suspend business relationship

## Requirements of Art. 10 (6)(a) and Art. 11 (7) (a) CS3D

- Last resort: use company's leverage
- If possible under applicable law
- Reasonable expectation that those efforts will succeed; the action plan shall include a specific and appropriate **timeline** for the adoption and implementation of all actions therein, during which the company may also seek alternative business partners

Goal: enforcing the implementation of enhanced prevention / corrective action plan



Icon: flaticon.com

## Remedies under the CISG: Suspension of performance

- Serious deficiency in the ability to perform Art. 71(1)(a); or
- Conduct in preparing to perform/performing the contract Art. 71(1) (b)
  - ✓ Code of conduct not sufficiently implemented
  - ✓ Refuse to participate in auditing
  - ✓ Refuse factory inspection
- Apparent that other party will not perform (forward looking nature of due diligence)
- Substantial part of obligations affected (Art. 8 interpretation)
- Consequences: Refuse to pay the price & to take delivery

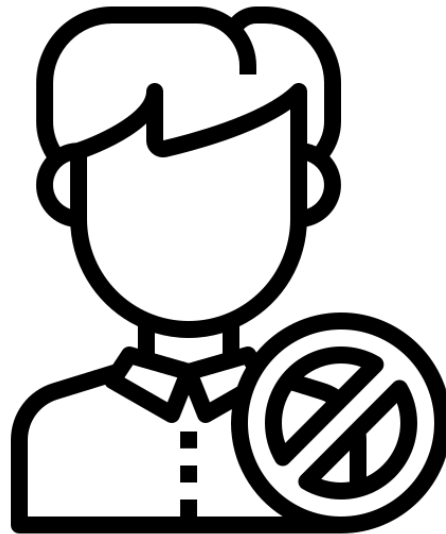
# CS3D & CISG: Terminate business relationship

## Requirements of Art. 10 (6)(b) and Art. 11 (7) (b) CS3D

- Last resort
- If possible under applicable law
- No reasonable expectation that enhanced prevention / corrective action plan will be successful / already failed
- Actual adverse impact is severe
- However, if expected impact of termination is more severe than the targeted adverse impact itself no need to terminate.

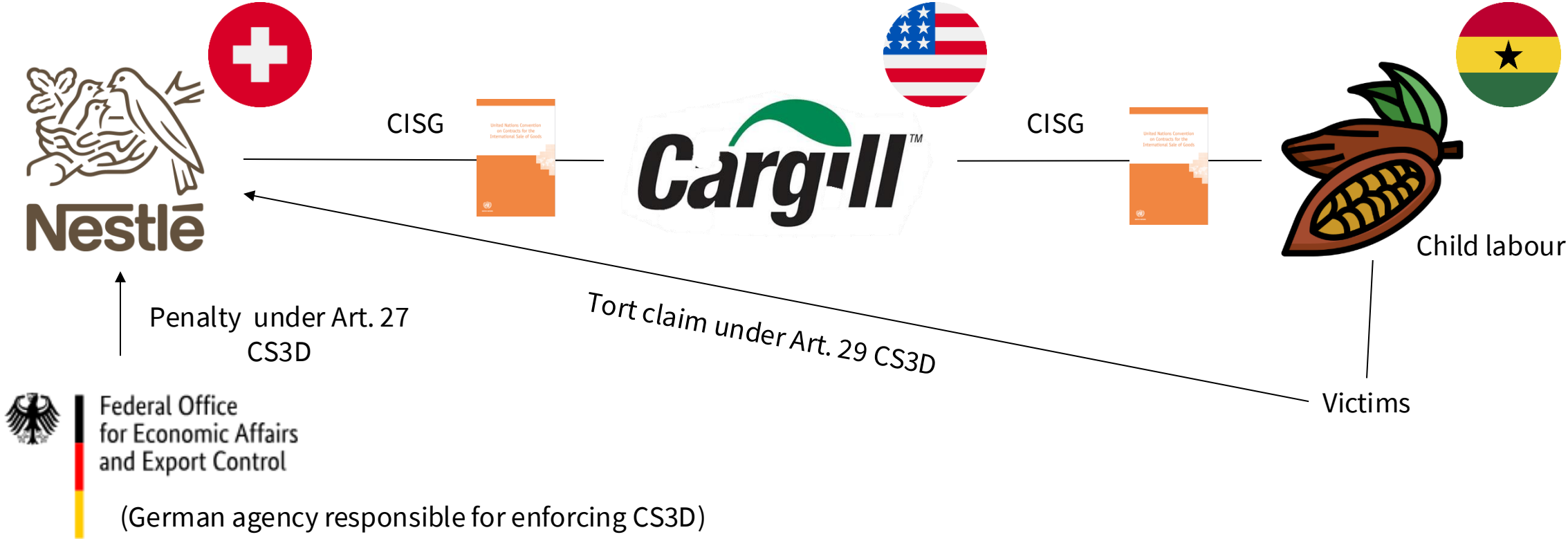
## Remedies under the CISG: Avoidance

- Art. 49(1)(a) CISG: avoid for fundamental failure to perform; only backward looking
- Art. 73(2) CISG: avoid entire contract if breach with regard to one instalment makes fundamental breach with regard to future instalments likely
  - ✓ Fundamental breach: similar to high threshold under CS3D (last resort, severe impact etc.);



Icon: flaticon.com

# CS3D & CISG: Redress for penalties and tort claims



Icons: Nestlé, Cargill, BAFA and flaticon.com



# CS3D & CISG: Redress for penalties paid according to Art. 27 CS3D

- Art. 74 CISG: *Damages for breach of contract by one party consist of a sum equal to the loss, including loss of profit, suffered by the other party as a consequence of the breach.*
  - ✓ Seller breached obligations contained in agreed code of conduct
  - ✓ Buyer suffered loss
  - ✓ Causal link is existent
  - ✓ Foreseeability?
- However:
  - ✓ The ratio legis of penalties / fines should also be taken into account
  - ✓ Calculation depends on earlier violations and shall not be less than 5 % of the net worldwide turnover of the company
  - ✓ The penalty might be also due to buyer's breach of control and cooperation duties ➡ Art. 80 CISG (next slide)



# CS3D & CISG: Redress for damages paid based on tort claims (Art. 29 CS3D)

- Art. 74 CISG: *Damages for breach of contract by one party consist of a sum equal to the loss, including loss of profit, suffered by the other party as a consequence of the breach.*
  - ✓ Seller breached obligations contained in agreed code of conduct
  - ✓ Buyer suffered loss:
    - Liability to third parties as consequential loss
    - Art. 5 CISG not applicable: damage was caused during the production of the goods, not by the goods themselves
  - ✓ Causal link is existent
  - ✓ Foreseeability?
- Exemption under Art. 80 CISG?
  - ✓ Failure caused also by own act or omission of the buyer:
    - E.g. due diligence under CS3D was omitted
  - ✓ Shared responsibility: Bundesgerichtshof (Germany), 26 September 2012, CISG-Online 2348: *'In cases of divisible remedies such as damages, the respective contributions to causation must be appropriately considered in the allocation of damages.'*

# Conclusion

- **International trend:** More and more national codes - like those based on the CS3D - will force companies to include into their sales contract code of conducts and due diligence provisions;
- CISG can accommodate the requirements of e.g. the CS3D fairly well;
- Advice to the parties:
  - Expressly include e.g. the duty to cooperate, the obligations of the parties, a right to suspend and to terminate;
- Advice to UNCITRAL:
  - Draft a model clause that can be included in the contract by the parties.

**Thank you for your attention!**

**Contact**

[yesim.atamer@ius.uzh.ch](mailto:yesim.atamer@ius.uzh.ch)

<https://www.crcl.uzh.ch/en.html>

<http://www.ius.uzh.ch/atamer>