DeutscherAnwaltVerein

Position Paper

of the German Bar Association by the Committees on Commercial Law, Corporate Social Responsibility and Compliance and Human Rights Law

on the proposal for a directive of the European Parliament and of the Council on Corporate Sustainability Due Diligence and amending Directive (EU) 2019/1937

Position Paper No.: 28/2022 Berlin, May 2022

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The German Bar Association (Deutscher Anwaltverein – DAV) is the professional body comprising more than 61.000 German lawyers and lawyer-notaries in 253 local bar associations in Germany and abroad. Being politically independent the DAV represents and promotes the professional and economic interests of the German legal profession on German, European and international level.

The DAV fights for the rule of law, democracy and human rights. The DAV is therefore of the opinion that the member states of the European Union and their companies, in view of the great international interdependence of their economies and the extensive integration into global procurement and sales markets, have the responsibility to ensure that internationally recognised human rights and environmental protection principles are also respected in international supply chains. The DAV also welcomes the proposal to regulate the due diligence obligations necessary for this purpose uniformly for all EU member states on the basis of a European directive, in order to avoid different regulations in the member states and the associated legal uncertainties and different competitive conditions for companies in the internal market. Nevertheless, the DAV would like to take a critical look at individual provisions of the draft directive.

General information

In the opinion of the DAV, the proposed directive encounters serious constitutional concerns with regard to the vagueness and abundance of far-reaching provisions on fines, sanctions and damages, which refer to an extensive catalogue (Annex 1) of international declarations and agreements, some of which are programmatic in nature. It is right to uphold and enforce these principles. However, it is up to the legislator, to whom the conventions under international law are fundamentally addressed, to put them into concrete terms. This concretization cannot be imposed on companies or left to the bodies responsible for enforcing the rules as contained in the directive. This is particularly true since such a specification of obligations by companies instead of by the responsible legislative leads in part to serious violations of the principle of certainty. In particular, this applies with regard to the considerable sanctions provided for in the draft directive in the event of violations of obligations, since the limits of what constitutes dutiful conduct are not defined in the directive in a sufficiently predictable manner. Therefore, the legislature itself must specify what is expected of companies. This also

requires the draft directive to address the dilemma that it requires companies to enforce rights in the value chain that are not enforceable, or only enforceable to a limited extent, with a number of the European Union's important trading partners and that cannot be enforced by politicians either.

This constitutional criticism of the vagueness of the regulations applies in particular because the scope of application of the proposed directive is not limited to the extensive catalogue of international declarations and agreements as contained in the annex. Rather, as can be seen from recital 25, it intends to regard even the violation of a prohibition or right not expressly listed in the annex to the directive, which leads to a direct impairment of a legal interest protected by the conventions, as a negative effect on human rights within the meaning of the directive. Such an indeterminate extension of the obligations of companies appears unacceptable from the point of view of the rule of law in view of the rules on fines, sanctions and damages as foreseen in the directive.

In the view of the DAV, it is absolutely necessary to exclude the activities of lawyers from the scope of the directive. The present proposal for a directive would cover lawyers both directly and indirectly. However, this is incompatible with the right to access to a lawyer, the free choice of lawyer and the requirement of lawyer-client confidentiality and thus the principle of the rule of law.

If the directive were applied directly to law firms, they would, for example, not be allowed to accept mandates from certain clients or would have to terminate any existing mandates. The law firm would also have to obligate its clients to comply with certain principles of conduct and implement extensive measures to review and monitor the client.
Lawyers as service providers in the value chain would also be indirectly covered by the present directive proposal. Among other things, the mandating company would have to conduct a due diligence review of the mandated law firm, which is simply incompatible with the requirement of attorney-client confidentiality.

Similar to e.g. Art. 3(3)(b) of Directive (EU) 2019/1937 of 23 October 2019 on the protection of persons who report infringements of Union law (Whistleblower Directive), it is therefore imperative that an exception be included in the proposed Directive; in the

present case, however, in the form of a full scope exception for mandate-related legal practice.

Re Art. 2 – Scope

The DAV suggests reviewing whether, according to Art. 2 para. 1 (if the size criteria are met), the mere fact that a company has been established under the laws of a Member State should oblige it to comply with the due diligence requirements. It seems more appropriate to require an actual connection to the European Union, i.e. at least also a registered office in the Union or minimum sizes of the economic activity in the Union. This applies in particular in view of the provision in Art. 2(4), according to which the jurisdiction of the Member States is to be based on the registered office of the companies.

According to Art. 3 a iv, supervised financial companies are also to be explicitly covered by the regulations. However, the size criterion of net turnover provided for in Art. 2 does not appear to be very suitable. Usually, a distinction is made between financial companies based on their balance sheet total.

Art. 2(4) is intended to regulate the jurisdiction of the individual Member States in the case of companies with a registered office in the European Union. However, a rule on jurisdiction with regard to the applicable national law and jurisdiction also appears to be necessary for companies to which, according to Art. 2(2), the directive is applicable based on their turnover in the European Union but without them having a registered office in the European Union.

Re Art. 3 – Definitions

For the sake of clarity, the definition of the term "sustainability aspects" should be included here by reference to Art. 2 No. 17 of the Accounting Directive (NEW). Cf. below with regard to Art. 15 Para. 1 Sentence 1 and on Art. 25 Paras. 1 and 2.

Preliminary remark on Art. 4-11

Art. 4-11 contain far-reaching organisational, auditing, action and reporting obligations for companies. In essence, in accordance with recognized principles for risk management, specifications are made for the organisational structure and the due diligence process, which are appropriately summarized in Art. 4. Requirements for each due diligence stage are concisely set out in Art. 5-11.. However, in sum, these requirements extend too far and are in part too vague.

This is due to a large extent to the regulatory technique with its reference to a large number of international agreements with partly general principles, which leads to a wide scope of protection with numerous lacks of definitions and uncertainties in the catalogue of obligations. One example are the protection provisions under labour law. The ILO Conventions No. 87 and No. 98 on the freedom of association and the right to organize mentioned in Annex Part I, Item 2, for instance, have not been ratified by the USA, China, India, Korea or Thailand. This raises the question of what due diligence obligations exist for companies with regard to their respective suppliers from these countries.

The requirements do not sufficiently distinguish between direct suppliers, with whom a contractual relationship exists, and indirect suppliers, with whom there is no direct business relationship and thus no direct possibility of influence. According to the draft directive, the same obligations should apply in principle to both direct and merely indirect suppliers for the identification of risks, the prevention and elimination of violations, and even for the suspension or termination of a supplier relationship. Only in terms of liability, Art. 22 Para. 2 provides for a certain relief for damages from indirect business relationships by granting the company management a business judgement with regard to the measures taken. Nevertheless, this means that the company must also take the measures described in Art. 5 *et seq.* for all indirect suppliers, regardless of the level and country. This undifferentiated obligation must already be rejected in accordance with the principle of "ultra posse nemo obligatur"; in any case, it does appear disproportionate and not appropriate. The German legislator has, for example, clearly differentiated between direct and indirect suppliers in its *Lieferkettensorgfaltspflichtgesetz* (LkSG) – “Due Diligence in Supply Chains Act” – in regard to the concrete risk analysis and the preventive and remedial measures. With regard to indirect suppliers, the company is only required to take action if it obtains

substantiated knowledge of a possible infringement of rights; the suspension and termination of the supply relationship with indirect suppliers is not provided for at all as an obligatory remedial measure (cf. also comments on Art. 6 and 7).

In case of infringements of human rights and adverse environmental impacts that cannot be remedied, the draft directive provides in Art. 8 Para. 3a) for (mandatory) financial compensation of the persons and communities affected by the company as a remedial measure. As neither a breach of duty nor culpability on the part of the company is a precondition and as the financial amount will regularly be incalculable, such a compensation obligation must be rejected (cf. also comments on Art. 8).

Re Art. 4 – Due Diligence

The specified elements of due diligence correspond to the established standard of risk management systems and are not objectionable. However, the wording of the Directive should already indicate that the company is not obliged to succeed in preventing or eliminating infringements of rights by external suppliers, but merely has to make an effort by taking the obligatory preventive and remedial measures (best effort). The wording of Art. 4 Para. 1c does not indicate this, but gives the impression of an obligation to succeed.

Re Art. 5 – Integrating due diligence into companies´ policies

Art. 5 Para. 1 is not objectionable. However, the annual review and update of the due diligence strategy provided for in para. 2 should be omitted. The established due diligence strategy will not be subject to annual changes. Thus, a mandatory annual cycle is not required and leads to unnecessary formalism and effort. In this respect, regular internal reporting on the results of due diligence to the relevant bodies is more important. Hence, we suggest replacing the annual update in Art. 5 (2) by a regular and occasion-related update or at least to extend the cycle to 3 years.

Regarding Art 6 – Identifying actual and potential adverse impacts

Companies are to be obliged to take appropriate measures to identify existing and potential infringements of human rights and adverse environmental impacts along the entire supply chain. This is reasonable with regard to the own company sphere and also for the activities of direct suppliers with existing contractual links, given that in these cases the company has the necessary information at its disposal or can contractually obtain access to it. However, the draft directive also covers indirect suppliers without differentiation, even if there are several stages of the supply chain between them and the obligated company. According to the definition in Art. 3 f, only suppliers that represent an “negligible or merely ancillary part“ are excluded. Although this *de minimis* provision is to be welcomed - despite the inherent difficulties of definition - it is not sufficient to appropriately differentiate the due diligence obligations of the company with regard to more distant indirect suppliers. It ignores the different factual and legal circumstances and the feasibility especially in cases of a multi-level supply chain with numerous indirect suppliers. Henceforth, the company would have to be aware of the details of all indirect supply contributions, including the associated production processes and working conditions at the relevant operating sites, and review them regularly in order to be able to identify current and potential infringements of rights protected under the draft directive. According to the ideas of the draft, this also includes consultations with the potentially affected groups of persons and employee representatives (Art. 6 Para. 4 Sentence 2). However, without an existing business relationship and corresponding direct legal relationship with the supplier, monitoring is simply not possible. The question also arises as to how the obligations of the company would relate to the corresponding behavioural obligations of the direct supplier, who alone has the contractual relationship with the indirect supplier and thus also the ability to intervene. Ultimately, the Directive should provide a graduated approach to the obligations of indirect suppliers. One option is to make duties to act with regard to indirect suppliers dependent on the company having substantiated knowledge of possible infringements of protected rights by the indirect supplier, similar to the approach of the German LkSG.

Re Art. 7 – Preventing potential adverse impacts

Art. 7 deals with measures to avoid and reduce risks of infringement, while remedial measures for infringements that have occurred are dealt with in Art. 8.

Re para. 2-4

In this context, the preventive action obligations under paras. 2-4 are reasonable in principle, but go too far in specific aspects. This applies, on the one hand, to the necessity of action plans which, in the event of increased complexity, companies should draw up and implement with the involvement of (potentially) affected stakeholders - along the entire supply chain - not only for the elimination of identified rights infringements, but already for the purpose of avoiding or reducing corresponding risks. This instrument should only apply to the elimination/reduction of infringements that have occurred and, beyond that, at most in the case of foreseeable, imminent complex infringements. Another problematic issue is the obligation to seek direct contractual agreements on compliance with the Code of Conduct with indirect suppliers if a contractual cascade via the direct suppliers does not lead to risk avoidance or reduction (Art. 7 Par. 3); the same applies to the monitoring obligation for indirect suppliers and the largely unspecified support obligation for SMEs in the supply chain (Art. 7 Par. 2 d, Par. 4). Such overlaps/interruptions blur the areas of responsibility of the individual legal entities in the supply chain and bear unnecessary potential for conflict. It should therefore be maintained that each supplier unit can regulate its supply obligation exclusively with its contractual partner and bears the expense for respective obligations itself.

Re para. 5

The far-reaching provision in Paragraph 5 according to which, even before the occurrence of an infringement of human rights and adverse environmental impacts, the waiver of an extension of the supply relationship and, if legally possible, the temporary suspension as well as, in the case of a risk of serious infringement of human rights and adverse environmental impacts, the termination of the business relationship is required, if the risk of infringement cannot be eliminated or adequately reduced by the other preventive measures of Article 7, should be deleted without replacement. Irrespective of the circumstances under which the complete termination of a supply relationship as a remedial measure in the event of an infringement of human rights and adverse environmental impacts may be required or reasonable, a corresponding obligation is to

be rejected in the preliminary stages of an infringement; something different can only apply if there is a foreseeable imminent serious injury. Firstly, a reliable assessment of whether or to what extent the risk of infringement can be eliminated or adequately reduced by other measures will not be possible in many cases, which is associated with corresponding uncertainties and risks of damages for the company under Art. 22. Secondly, the ultima ratio intervention already in the risk phase appears disproportionate.

A suspension or termination of the supply relationship with an indirect supplier is also extremely problematic as a mandatory measure. Since the company has no direct business relationship with the indirect supplier, it cannot suspend or terminate such a relationship. The only option would be to influence the direct supplier to take appropriate action against the indirect supplier. In the event of a refusal (by the indirect or the direct supplier), the termination of the business relationship with the direct supplier could then be considered as a final consequence. Due to the obvious difficulties of such a construction, the German legislator has in the end refrained from the termination of the business relationship as a mandatory measure against the indirect supplier for good reasons (see § 9 LkSG). The Directive should also make a clearer distinction between indirect and direct suppliers in this respect.

Regarding Art. 8 – Bringing actual adverse impacts to an end

The obligations to act under Art. 8 to remedy an infringement of the rights protected are largely based on the requirements of Art. 7 for risk avoidance; the regulatory content of Art. 8 Para. 3 b-f, 4-7 is identical to that of Art. 7 Para. 2 a-e, 3-6. In addition, Art. 8 Para. 2, 3 a deals with the compensation or minimisation of impairments that cannot be averted by the company. According to Art. 8 Par. 3 a, compensation or minimisation of the negative consequences of an impairment that cannot be averted requires the payment of damages to the affected persons and financial compensation of the affected communities by the company. This provision is also very important because the obligation to pay does not require any breach of duty or fault on the part of the company and in this respect - corresponding to a warranty liability - goes further than the civil liability provided for in Art. 22. The effect of combining Art. 8(3a) with Art. 8(6) and Art. 22, not only for individual cases, is the following: All supplier states in which the

European protection standard laid down in the directive is not met become highly problematic for the companies, as they must assume that the supplier companies in these states also do not meet the protection standard, e.g., in the area of labour protection rights. Since the framework conditions cannot reasonably be changed by the individual company, the only choice is between financial compensation, the amount of which can hardly be estimated (Art. 8 Par. 3 a), termination of the supplier relationship (Art. 8 Par. 6) or a threat of damages (Art. 22). Regardless of the company's decision, it must expect incalculable risks or a noticeable impairment of its performance and competitiveness. This compensation provision therefore goes too far and should in any case be dropped by deleting Art. 8 Para. 3 a Sentence 1, 2nd clause.

Also to be rejected is an obligation to temporarily suspend or terminate the business relationship with an indirect supplier in the cases mentioned in para. 6 (see comments on Art. 7).

Regarding Art. 9 – Complaints Procedure

The requirements for the establishment of a complaints system covering the entire supply chain go too far in individual points and open up numerous possibilities for abuse (including for political purposes), which can lead to considerable burdens for companies:

Re para. 1

The possibility of complaints to the company regarding actual or potential negative impacts of the business activities of the company, its subsidiaries and its value chains on human rights and the environment are considered to be appropriate in its intention. However, in order to achieve an appropriate limitation, the scope should be limited to specific impairments and not extended to all potential risks. The relationship to Art. 23 and the Whistleblower Directive also remains unclear in this respect.

Re para. 2

The right of appeal provided for in Para. 2 a seems appropriate for persons who are already affected or have justified reason to believe that they could be affected by negative consequences. Paragraphs 2 b and c expand the group of persons entitled to file complaints. The DAV also considers this to be appropriate in view of the requirement of having to raise justified concerns in Paragraph 1.

Re para. 3

It is appropriate to require companies to set up a procedure for handling complaints. However, instead of informing the employees and trade unions concerned individually about the procedure, consideration should be given to providing centralized information about the established complaints procedure on the company's homepage. The German LkSG could serve as a model in this respect, according to which the rules of procedure must be laid down in text form and made publicly accessible.

Re para. 4

It is consistent that complainants should be entitled to be informed about the further course of the complaint. The English version of the draft directive gives complainants the right to an "appropriate follow-up". However, this right to a follow-up should also be limited in order to avoid endless procedures.

The cumulative right to meet representatives of the company and to discuss the subject of the complaint with them also appears to be too extensive. Firstly, the right to communication beyond a written exchange should only exist if there are sufficient indications that the complaint is well-founded. Secondly, a right to a physical meeting seems excessive in today's times of digital communication. Companies should be able to decide in which appropriate form they wish to exchange information with the complainants.

Re Art. 10 – Monitoring

An assessment of the effectiveness of the due diligence system is required, including the entire supply chain, to be carried out at least every 12 months and, if necessary,

additionally on an *ad hoc* basis. A regular annual cycle seems excessive and not necessary. Since the assessment is supposed to cover the activities and processes of all (direct and indirect) suppliers relevant to the supply chain, the assessment causes considerable cost and time expenditure in the case of longer supply chains; if repeated annually, there is a risk of attrition to a formalized routine. Therefore, a regular assessment should be provided for at longer intervals at most, and otherwise an assessment on an *ad hoc* basis should suffice; at the very least, the cycle in Art. 10 Sentence 2 should be increased to 3 years. In addition, with regard to indirect suppliers, the fact that the company has no direct possibility of access and assessment must be taken into account; in this respect, the concept of "contractual cascading" should be applied, as in Art. 7 para. 2 b, Art. 8 para. 3 c.

Re Art. 15 – Combating climate change

General

Notwithstanding their essentially justified concern, Art. 15 para. 1 and 2 should be fundamentally revised. Art. 15 para. 3 is likely to have only a very limited independent scope of application due to its triple conditionality and should therefore be deleted. In detail, the DAV has the following comments and suggestions regarding Art. 15:

Re para. 1 sentence 1

According to Art. 15 para. 1 subsection 1 companies based in the EU that meet the size criteria of Art. 2 para. 1 a shall adopt "a plan to ensure that the business model and strategy of the company are compatible with the transition to a sustainable economy and with the limiting of global warming to 1.5 °C in line with the Paris Agreement."
A sustainability and climate plan is therefore required. As far as sustainability is concerned, the draft directive does not contain its own definition. Recital 63 refers to Directive 2013/34/EU (Accounting Directive) with regard to sustainability aspects. The draft Directive of the European Parliament and of the European Council amending Directives 2013/34/EU, 2004/109/EC and 2006/43/EC and Regulation (EU) No. 537/2014 concerning corporate sustainability reporting (CSRD-E) aims to introduce a corresponding definition into the Accounting Directive. According to Art. 2 No. 17 of the Accounting Directive (NEW), sustainability aspects shall include the sustainability

factors described in Regulation (EU) 2019/2088, i.e., environmental, social and labour concerns, respect for human rights and the fight against corruption and bribery, as well as governance factors. Due to the central importance of sustainability aspects in the context of the draft directive, it would make sense to include the definition - by reference to Art. 2 No. 17 Accounting Directive (NEW) - in Art. 3 of the draft directive. The Climate Plan is likely to be primarily concerned with describing the company's path towards Net-Zero 2050. In the following discussion, the focus is on the climate plan in accordance with the emphasis of Art. 15 Para. 1 and Para. 2.

The relationship of Art. 15 para. 1 sentence 1 to Art. 1 para. 3 CSRD-E is unclear. Art. 1 para. 3 CSRD-E is intended to introduce a new Art. 19a into the Accounting Directive. The regulations on sustainability reporting contained in Art. 19a of the Accounting Directive (NEW) stipulate in Para. 1 that the management report of large and - after a transitional period - also small and medium-sized companies must include information "which is necessary for an understanding of the sustainability-relevant effects of the company's activities as well as for an understanding of the effects of sustainability aspects on the company's business performance, business results and situation". According to Art. 19a (2) a iii Accounting Directive (NEW), the aforementioned sustainability-related information also includes information on "how the company intends to ensure that its business model and strategy are compatible with the transition to a sustainable economy and the limitation of global warming to 1.5°C in accordance with the Paris Agreement."

The disclosure requirement under Art. 19a para. 2 a iii Accounting Directive (NEW) implicitly requires a corresponding plan to align the business model and strategy of the entities with climate change. Without such a plan, covered entities cannot comply with their disclosure obligation, especially since there is no "comply or explain" rule regarding whether or not a business model and strategy is compatible with the objectives of the Paris Agreement. Therefore, a reference to Art. 19a of the Accounting Directive (NEW) should be made in Art. 15 para. 1 sentence 1 and the relationship between the two provisions should be clarified.

In addition, the draft directive as a whole and thus also the obligation under Art. 15 para. 1 sentence 1 are based on a purely company-related approach and do not take

account of group issues. A separate climate plan for the parent company and each group company that meets the size criteria would not be appropriate. Rather, it is more appropriate and should at least be possible for a climate plan to be defined by the parent company for the entire group. This concept is also the underlying principle of Art. 19a para. 7, Art. 29 and Art. 29a Accounting Directive (NEW) for disclosure requirements, which already implicitly presuppose the obligation to determine the relevant intentions and thus a group-wide climate plan.

Already today, investors are demanding a climate plan from stock corporations, and the majority of major companies, certainly, are also submitting such plans. Thus, Art. 15 para. 1 sentence 1 might provide added value by establishing a binding definition for a net zero company and standardising the contents of the climate plan, which would increase its significance and improve comparability with other companies. Standardized content of a climate plan could include, for example, setting reduction targets for total GHG emissions in a company's value chain according to a science-based 1.5°C pathway as well as reduction measures to compensate for remaining GHG emissions. Eligible removal mechanisms could be set out in a delegated act.

Re para. 1 sentence 2

According to Art. 15 para. 1 sentence 2, the climate plan shall in particular contain information on the extent to which climate change poses a risk to the company's business activities or has an impact on them. The starting point and yardstick for this assessment must be the interests of the company. On the one hand, the management of every company is obliged under general principles of company law to identify and manage the risks relevant to its business activities. On the other hand, Art. 19 (1) of the Accounting Directive obliges companies to disclose the risks that are material for the company as part of the management report. This obligation is to be concretized for sustainability aspects in Art. 19a (2f) of the Accounting Directive (NEW) to the effect that the information on sustainability aspects to be disclosed as part of the management report also includes "a description of the most important risks to which the company is exposed in connection with sustainability aspects, including the most important dependencies in this area, and the way in which it manages these risks". From the context of Art. 19a para. 1, 2 a iii and 2 f, it is clear that sustainability aspects include

climate change. Similar to what has already been stated above with regard to para. 1 sentence 1, the disclosure obligation here is also implicitly based on a risk identification obligation - which already exists under company law. Therefore, full consistency with Art. 19 para. 2 f Accounting Directive (NEW) should be established.

Re para. 2

According to Art. 15 para. 2, companies should be obliged to include emission reduction targets in their climate plan if climate change has been identified or should have been identified as a major risk or impact of the company's activities. Again, the general principles of company law require companies to monitor, manage and minimize significant risks in their business activities as part of their risk management. The same applies to significant (negative) impacts of their business activities. This includes setting corresponding reduction targets.

As stated above with regard to para. 1 sentence 1 for the Climate Plan, it is also not reasonable to consider emission reduction targets on an individual company basis. Rather, it must also be possible for the parent company to set the emission reduction targets for the group.

With this in mind, the DAV proposes the following editorial revision:

> "Member States shall ensure that, in case climate change is ~~or should have been~~ identified **actually or potentially** as a principal risk for, or a principal impact of, the company’s operations, the company includes emission reduction objectives in its plan."

Re para. 3

Art. 15 para. 3 provides that "the fulfilment of the obligations referred to in paragraphs 1 and 2" shall be "duly" taken into account when determining the variable compensation of members of the Executive Board, provided that the following three conditions are (cumulatively) met: The variable renumeration is linked to the contribution of a director

(i) to the strategy, (ii) to the long-term interests and (iii) to the sustainability of the company.

It is doubtful whether there is an independent scope of application for Art. 15 para. 3. If there is a long-term variable remuneration component for members of the Executive Board in large companies, which is linked to strategic objectives and sustainability criteria, then it is hardly conceivable that the development into a net zero company and the achievement of emission reduction targets do not play a role in the criteria for variable remuneration. If there are isolated cases where this is not the case, these will in any case not have a significant impact on the achievement of the climate targets from the Paris Agreement. Therefore, there is no need for a regulation in a directive. Conversely, there will be a large number of remuneration systems for which not all of the three cumulative conditions set out in Art. 15 para. 3 are met, and which then do not fall within the scope of Art. 15 para. 3 from the outset.

If the EU Commission adheres to Art. 15 para. 3, the DAV suggests at least a clarification of the content. The reference to "the fulfilment of the obligations referred to in paragraphs 1 and 2" is not clear. The obligation under Article 15 para. 1 relates to the establishment of the climate plan, at least according to its wording. This obligation is not likely to be meant when determining the criteria for variable compensation. Rather, it is likely to concern the implementation of the climate plan, i.e., the alignment of the business model and strategy with the objectives of the Paris Agreement. The same applies to the obligation under Art. 15 para. 2, which, according to its wording, relates to the setting of emission reduction targets in certain cases. In the context of determining the variable compensation, the focus should be on the implementation of the emission reduction targets. The DAV therefore suggests that, if the EU Commission does not wish to dispense with this entirely, Art. 15 para. 3 should be reworded as follows:

> “Member States shall ensure that companies ~~duly~~ take ~~into~~ **due** account ~~the fulfilment of the obligations referred to in paragraphs 1 and 2~~ **of the level of implementation of the plan referred to in paragraph q and of the objectives referred to in paragraph 2** when setting variable renumeration, …”

Re Art 16 – Authorised representative

In Art. 16, the appointment of an authorized representative is to be prescribed for companies outside the EU that fall within the scope of the Directive pursuant to Art. 2 para. 2. This authorized representative must be a natural or legal person established or domiciled in a Member State of the EU in which the company operates (para. 1) and whose contact details must be notified to the supervisory authority (para. 2). Whether this is sufficient to enforce the intended extraterritorial scope of the EU Sustainability Directive is yet unclear. The draft directive leaves many questions open in this respect, for example what applies if an enterprise covered by Art. 2 para. 2 does not appoint an authorized representative or how the supervisory authorities can effectively take measures against such enterprises or impose sanctions.

Re Art. 19 – Substantiated concerns

As is already the case under the German LkSG, the draft directive also requires companies to set up a complaints procedure. This is intended to enable natural and legal persons to report justified concerns about actual or potential adverse human rights or environmental impacts in connection with the business activities of the company, its subsidiaries or the value chain. In contrast to German law, the draft directive provides for the obligation to establish public reporting channels with supervisory authorities to receive indications of due diligence violations (Art. 19 para. 1). If a complaint is made to a supervisory authority that is not competent, it must forward the complaint to the appropriate supervisory authority. The supervisory authority must inform the person concerned as soon as possible of the results of its investigation and give reasons for its decision (Art. 19 para. 5). This in turn must be subject to a right of appeal (Art. 19 para. 5).

For the DAV, the legal recourse envisaged before state complaint authorities appears to be excessive and problematic, particularly in the case of stock corporations, for example if a listed company is in the process of investigating possible legal violations in the supply chain in a self-exculpatory situation pursuant to Art. 10 para. 4 of the Market Abuse Regulation (MAR) and is forced under certain circumstances to make an *ad hoc* notification as a result of a report to a supervisory authority. Therefore, the official complaint procedures should at most be opened subsidiary to internal company

reporting channels, i.e., justified complaints should first have to be articulated to the companies concerned and only if these fail to remedy legal violations in the supply chain the direct route to the supervisory authority should be opened. Such an arrangement by the national legislator is likely to be permitted by the draft directive in its current version already. However, a corresponding clarification would be welcome.

In addition, the scope of application of the EU Whistleblower Directive is to be expanded to include the reporting of violations of the requirements of the draft directive and the protection of the reporting persons (Art. 23). This should apply equally to internal company complaint procedures as well as to complaints against public authorities.

Re Art. 20 – Sanctions

With regard to the possible range of fines, the draft directive, like Section 24 of the German LkSG, aims to link the fine with the company’s turnover (Art. 20 para. 3). Such a link to turnover link indeed follows the "trend in sanctions law". However, it is objectively to be criticised, since the turnover does not reflect the company's performance. Here, though, it must be taken into account that the draft directive does not provide for mandatory monetary sanctions, but only generally stipulates that the sanctions to be imposed for violations of supply chain regulation must be "effective, proportionate and dissuasive" (Article 20 para. 1). The draft directive only requires a mandatory link to turnover if financial sanctions are imposed ("When pecuniary sanctions are imposed ..."). This can be problematic with regard to the "level playing field" envisaged by the EU Sustainability Directive if some Member States waive monetary sanctions while others impose very far-reaching turnover-related fines for infringements in the supply chain. In this respect, standardization at the European level would be desirable.

The approach of the draft directive is to be welcomed, to take into account, when imposing sanctions and their amount, the company's efforts to comply with the remedial measures required by a supervisory authority, preventive measures taken by the companies or measures to remedy deficits in the supply chain, as well as cooperation with other companies to address negative effects in the value chain.

In contrast, the approach of "naming and shaming", which the draft directive adopts (Art. 20 para. 4) - although also in line with the "sanctions law trend" - appears problematic. Particularly the broad scope of the Directive means that not only stock corporations are affected, but also medium-sized family businesses that are not subject to the general transparency obligations under capital market law. For these, the publication of a decision by the supervisory authorities may even represent a more serious intervention than the actual sanction itself. This seems particularly inappropriate in the initial phase, when companies lack experience in dealing with the new legal requirements in the supply chain and general market standards have not yet emerged. Therefore, a differentiation between capital market-oriented and non-capital market-oriented companies would be appropriate in this respect.

In contrast to the German LkSG, the draft directive does not provide for an exclusion from the public procurement procedure in the event of infringements of the directive's provisions. Rather, Art. 24 merely stipulates that companies applying for public support (subsidies) must confirm that no sanctions have been imposed for non-compliance with the obligations under this Directive. Thus, the Directive would fall significantly short of the possibility provided for in Section 22 of the German LkSG to order exclusion from public procurement above a certain threshold of fines. This appears problematic with regard to the "level playing field" in the European internal market intended by the Directive and could lead to a disadvantage for those companies that fall within the scope of the German LkSG.

Re Art. 22 – Civil liability

Preliminary remarks

In addition to the first pillar of public enforcement through sanctions by the national supervisory authorities, the proposal provides for a second pillar of private enforcement through the civil liability of companies in order to fulfill the due diligence obligations of the companies pursuant to Articles 7 and 8.

The proposal thus clearly goes beyond the regulatory approach of the German LkSG: the latter does not provide for an independent, specific liability in the case of breaches of due diligence in the value chain, but leaves the question of liability to be assessed by the courts according to the general rules of tort law. According to these general tort law rules, a civil liability of companies for the conduct of group subsidiaries and contractual partners in the value chain is generally excluded. The (parent) company can only be held liable in tort if special qualified conditions are met, such as actual control of the source of risk or intensive control of subsidiaries or contractual partners in the value chain.

In the EU, the establishment of a special legal responsibility under civil law that goes beyond this has so far only been provided for in France. The proposal obviously represents an attempt at a compromise between the less far-reaching regulation in Germany and the even more far-reaching ideas of the EU Parliament, which, with a reversal of the onus of proof, would eventually result in a liability for success. However, such a compromise is not appropriate. It would lead to a situation in which, contrary to the principle of separation under group law, parent companies would be liable for breaches of due diligence by their subsidiaries in connection with human rights and environmental issues on the basis of Article 6 para. 1, and a far-reaching liability for the misconduct of third party contracting parties would be introduced. Above all, however, there is no need for far-reaching civil liability because the protection provided through public enforcement by national supervisory authorities already constitutes sufficient pressure on companies to comply with their due diligence obligations.

Such public enforcement is also a preferable regulatory approach to shifting civil liability to companies. The state and its regulators may set a clear, proportionate and reasonable framework for companies to comply with their due diligence obligations. However, they must not demand that companies enforce rights and obligations in the value chain that are not enforceable or only enforceable to a limited extent with a number of important trading partners - including on the part of the EU and its member states themselves - and then even introduce civil liability in the event of a breach of these obligations. In addition to the sanction mechanism of public enforcement, the supplementary guidelines to companies could be expanded.

Moreover, there is no need for private enforcement in addition to public enforcement because there is already an additional pillar in the form of a company law standard of obligations for corporate bodies. Companies are already obliged to report on risks in the sustainability report. The draft directive now additionally provides for an orientation of the material duties to act of the corporate bodies towards an avoidance of human rights violations and environmental violations. Even this explicit expansion of the duty standard is unnecessary, because the corporate bodies must fulfil the legal duties of the companies anyway (duty of legality). In combination with public enforcement, the obligation of corporate bodies under company law is sufficient for a sustainable orientation of companies towards the avoidance of human rights due diligence violations.

And finally, in addition to public enforcement and the obligation of corporate bodies under company law, consumer behaviour (consumer enforcement) and investor behaviour (investor enforcement) should also make additional civil liability unnecessary. As the Commission rightly points out in its Q&A on the draft directive, consumers and investors are increasingly paying attention to compliance with rules on the protection of human rights and the environment and punish companies whose conduct does not sufficiently take these standards into account.
The three-pillar model now proposed with additional private enforcement would overburden EU companies and ultimately expose them to unacceptable liability risks.

Re para. 1

Article 22 para. 1 provides for civil liability of companies for damage if they have failed to fulfil their obligations under Articles 7 and 8 and, as a result of this failure, negative effects have occurred which, in particular, should have been avoided or minimised and which have led to damage. Civil liability is therefore linked to a culpable breach of the duty of care which has causally led to damage.

Recital 58 clarifies that a regulation on the onus of proof is not included and that this question is to be left to the national legislator. The proposal thus falls short of the ideas of the European Parliament, which had proposed a onus of proof rule to the detriment of companies. The renunciation of such a regulation is also imperative to avoid burdening

EU companies with a de facto success liability and thus unmanageable liability risks. Otherwise, EU companies would be subject to a standard of liability that would not apply anywhere else in the world. This would lead to massive competitive disadvantages for EU companies and to a heavy burden on Member State courts due to the high international attractiveness of lawsuits against EU companies.

Re para. 2

Para. 2 provides for certain relief from liability for damages resulting from the activities of indirect partners. In this respect, the company management is granted a business judgement with regard to the measures actually taken and to the verification of compliance with due diligence obligations, in particular in the case of compliance with contractual cascade regulations, provided that the measures are suitable to avoid or minimise the negative effects. Efforts by the company in connection with public enforcement must be taken into account.

If at all a separate civil liability of companies for due diligence violations in the value chain is provided for, at best this liability approach, which grants companies a certain safe space of reasonable business judgment, would be justifiable. For damages from merely indirect business relations, however, the explicit exclusion of liability under special law should remain, with recourse to the general national liability rules.

Paras. 3 and 4

Paragraph 3 consistently clarifies that the civil liability of a company does not affect that of its subsidiaries or direct business partners. It is also appropriate that any stricter general liability in situations not covered by this Directive remains unaffected (para. 4).

Re para. 5

When providing for special civil liability under the law, it is consistent that Art. 22 para. 5 makes the provision an overriding mandatory provision within the meaning of Art. 16 of the Rome II Regulation. This ensures that it also applies if the claim itself would be subject to the law of a third country. Otherwise, civil liability in such cases would run

empty. It is also coherent that the proposal is not limited to only structuring the duty of care as an interference standard, but also for the consequences of the liability. This ensures that national law applies equally to the prerequisites for liability and the legal consequences.

Re Art. 25 – Directors` duty of care

Re para. 1

Para. 1 is intended to oblige the members of the management of companies with their registered office in the EU, which fall within the scope of the draft directive, "when fulfilling their duty to act in the best interests of the company, [to] take into account the consequences of their decisions for sustainability matters, including, where applicable, human rights, climate change and environmental consequences, including in the short, medium and long-term". According to Recital 63, Article 25 para 1 is intended to "clarify, in a harmonised manner" that the duty of care of directors towards the company also includes the duties of care included in the draft directive and that directors must systematically take sustainability aspects into account in their decisions.

If Article 25 para. 1 is merely a clarification that sustainability aspects are to be included in the consideration of management decisions alongside all other interests covered by the company, the question arises whether there is a need for regulation. Mentioning this particular point in the recitals would be sufficient as a clarification. The DAV therefore pleads for a deletion of Art. 25 para. 1. This is also supported by the fact that it is not objectively justified to regulate sustainability-related due diligence violations only for companies within the scope of application of the draft directive, i.e., only for companies that meet certain size criteria.

If the EU Commission wishes to adhere to Art. 25 para. 1, there is a need for revision in several respects:

Firstly, it should be ensured that the regulatory content of the standard, given that the term "director" according to the legal definition in Art. 3 o includes members of the administrative, management and supervisory body, also fits a two-tier governance

system in which the members of the supervisory body do not make management decisions but monitor them.

Secondly, the focus should not be on the duty to act in the best interests of the company but, consistent with the title, on the duty of care of the members of the management. This would take into account the fact that in some legal systems a dogmatic distinction is made between the "duty of care" and the "duty to act in good faith".

Thirdly, it should be clarified that sustainability aspects do not per se have a special or higher weight than other aspects to be taken into account when weighing up interests in the context of management or approval and monitoring decisions. This would also ensure that the entrepreneurial discretion also refers to the weighing of sustainability aspects, unless mandatory legal regulations have to be observed for their protection.

Furthermore, redundancies in the wording should be eliminated. As stated above with regard to Art. 15 para. 1 sentence 1, "sustainability aspects" in the sense of the draft directive are to be understood as environmental, social and employee concerns, respect for human rights and the fight against corruption and bribery, as well as governance factors through the reference to the Accounting Directive in recital 63. Therefore, in addition to the mention of sustainability aspects, there is no need to separately mention human rights, climate change and the environment in Art. 25 para. 1. If no definition of sustainability aspects is planned to be included in Art. 3, explicit reference should be made to "sustainability aspects within the meaning of this Directive" for clarification.

A revised para. 1 could read as follows:

> *(1) Member States shall ensure that the fulfilment of the duty of care towards the company by directors in the exercise of their management functions referred to in Article 2 para. 1 includes giving due consideration to the short, medium and long-term implications for sustainability aspects within the meaning of this Directive in the context of management decisions when weighing up all relevant concerns.*

Re para. 2

If Art. 25 para. 1, as stated in recital 63, is a clarification that the duty of care of directors towards the company also includes the consideration of sustainability aspects, there is no need for an explicit clarification that the general rules of company law apply to the existence of a breach of sustainability-related duties of care of the members of the company management and its consequences. Art. 25 para. 2 should therefore be deleted to avoid misunderstandings. If the EU Commission wishes to retain Art. 25 para. 2, the provision should be revised as follows:

> *(2) Member States shall ensure that the question of whether and to what extent the insufficient consideration of sustainability aspects within the meaning of this Directive by directors of a company constitutes a breach of their duty of care towards the company and whether and to what extent they are liable to the company for any damage resulting therefrom shall be governed by their generally applicable laws, regulations and administrative provisions.*

Re Art. 26 – Setting up and overseeing due diligence

On para. 1 sentence 1 and para. 2

Recital 64 should clarify that para. 1 sentence 1 and para. 2 refer to the assignment of responsibility for the aforementioned tasks to the directors in their management function. Understood in this way, Art. 26 para. 1 sentence 1 and para. 2 appear appropriate. However, in this context it is unclear how the appropriate consideration of the contributions of stakeholders and non-governmental organisations in para. 1 sentence 1 is to be understood. The obligations of para. 1 sentence 1 are genuine corporate governance obligations in the areas of compliance and risk management.

Re Article 30 – Transposition

The transposition period of only 2 years provided for in para. 1 a for companies pursuant to Art. 2 para. 1 a appears too short for the DAV. In view of the immense

burdens that European business enterprises have to bear due to the Covid-19 pandemic and due to the sanctions and other effects in the wake of the Russian attack on Ukraine, the EU economy first needs an appropriate reprieve. The implementation of the draft directive will mean a considerable organisational and financial effort for the companies concerned, which should not be expected of them in the short term due to the current economic situation. The DAV is therefore in favour of an implementation period pursuant to para. 1 a of not less than 3 years after the Directive enters into force; the implementation period pursuant to para. 1 b should be extended accordingly to at least 5 years.

Concerning the affectedness of the legal profession

In the DAV's view, it is absolutely necessary to exclude lawyers' activities from the scope of application of the Directive. Otherwise, the right to legal assistance guaranteed in Article 47 (2) of the European Charter of Fundamental Rights and the requirement of lawyer-client confidentiality protected by Article 8 of the European Convention on Human Rights and Fundamental Freedoms as well as the position of the lawyer as an independent organ of the administration of justice would be inadmissibly impaired.

The present proposal for a directive affects lawyers directly and indirectly. Law firms that meet the requirements of Art. 2, Art. 3 lit. a) would be directly obliged to comply with the due diligence set out in Art. 4 *et seq.*,

- to identify actual and potential negative impacts on human rights and the environment arising from the business relationship with the client, Art. 6 para. 1,
- to "seek contractual assurances [from the client] that [they] will ensure compliance with [the firm's] code of conduct and, as necessary, a prevention action plan", Art. 7 para. 2 b,
- to accompany these contractual assurances with appropriate measures to verify compliance, Art. 7 para. 4,
- to remedy or minimise actual or negative impacts on human rights and the environment resulting from the business relationship with the client, Art. 8 para. 1 and 2,

- to neutralise or minimise the negative impacts, including through the payment of compensation to affected persons and financial compensation to affected communities, Art. 8 para 3,
- not to enter into new relationships with the client or to develop existing relationships, Art. 8 para. 6,
- to temporarily suspend or terminate business relations with the client, Art. 8 para 6 a and b.

All of this is in complete contradiction to the right of access to a lawyer and the free choice of lawyer enshrined in Art. 47(2) European Charter of Fundamental Rights.

Also indirectly, lawyers as service providers in the supply chain would be affected by the present draft directive. This would have the consequence that the mandating company, insofar as it falls within the scope of the draft Directive, would have to carry out an assessment of the mandated law firm in accordance with Art. 10. In practice, such "due diligence" is often consistently secured by extensive contractual obligations to provide information as well as rights of access and inspection. In the case of lawyers, this is simply incompatible with the requirement of lawyer-client confidentiality.

Direct application of the Directive to law firms

Large law firms, if they meet the criteria set out in Art 2, Art 3 a, can fall directly within the scope of the Directive, but unlike under the German LkSG only if they are organised as legal persons and not as partnerships, since only legal persons are deemed to be undertakings within the meaning of the Directive under Art 3 a. This differentiation already is not convincing and even problematic from an equality perspective, as a differentiation without an objective reason constitutes discrimination. The question of whether and to what extent law firms should be direct addressees of the new supply chain regulation should be answered regardless of whether a law firm is organised as a partnership or as a corporation. Notwithstanding this particular point, the DAV advocates for a general exemption for the legal profession, as it did with regard to the German LkSG.

Lawyers indirectly affected in the supply chain of covered companies

In any case, all law firms under Art. 3 e - g may in principle be included by the broad definition of "business relationship" or "established business relationship" and "value chain". The UN Guiding Principles on Business and Human Rights, whose implementation the draft directive serves to implement, assume that, in principle, law firms and other professionals can also be part of the supply chain. It can therefore also be assumed that, unless a clarification is made, lawyers as service providers and thus companies in the supply chain of other companies will at least indirectly be affected by the draft directive.

Incompatibility with the special role of the legal profession under the rule of law

Treating the legal profession indiscriminately like other companies, suppliers and service providers is incompatible with its role as an organ for the administration of justice, at least to the extent that it advises or represents clients. As an instrument of justice, the lawyer is indispensable in order to fulfil the guarantee contained in Article 47(2) of the European Charter of Fundamental Rights that every person may be advised, defended and represented by a lawyer he or she trusts.
The legal profession has the public task, required by human rights and the rule of law, of opening up and guaranteeing everyone access to the law and to the courts through access to a lawyer.

The professional role of the legal profession is fundamentally defined by the legislature and the lawyers' self-government. A (partial) modification of this public role by the draft directive, which does not provide for any consideration of confidentiality obligations of lawyers or other professional secrecy holders, is obviously not wanted. Otherwise it would have had to deal with it. A modification of the public role of lawyers based on the draft directive through supplier codes designed by their clients amounts to an inadmissible "privatisation", at least insofar as the public role of advising and representing clients may be affected. Ultimately, this may even lead to clients defining professional conduct obligations of lawyers and law firms and the question of who should be granted access to justice, without the involvement of the legislature or the bar associations. This contradicts the public function of the lawyer as part of the

administration of justice, whose activity and independence required by human rights must be guaranteed by state regulation.

Extensive control mechanisms in the supply chain

In practice, the control mechanisms to be established by companies in the supply chain within the framework of their due diligence obligations according to Art. 4 *et seq*. often include extensive questionnaires, which inquire about compliance with the respective human rights and environmental expectations on the part of the supplier and its business partners and supply chains, often coupled with extensive obligations to provide evidence. The control measures sometimes also include (unannounced) audits to check compliance with the "expectations" throughout the supplier's business operations. The questionnaires are often designed in the same way for all suppliers in an undifferentiated manner and do not take into account the special features of the legal profession, especially confidentiality obligations. This also applies to audits that comprehensively examine the business operations and books of law firms and thus want to gain access to confidential mandate-related documents. In addition to relevant internal policies, documentation of compliance with these policies is often required. These requirements are mostly to be applied undifferentiated also to lawyers and other holders of professional secrecy. They are to apply to the entire law firm and all employees and activities, i.e., not only to the specific mandate and not only to the law firm with regard to its economic activity, but also to the core of legal activity for other clients, which is subject to confidentiality. The requirements sometimes even go so far as to say that a lawyer must not cause, contribute to or be directly associated with negative impacts on human rights of others through his or her mandate activities. There are also some demands that law firms, as part of their know-your-customer policies, should not only consider the legally prescribed corruption and money laundering issues, but also possible negative impacts on human rights and the environment through their work for current and potential clients. They should refrain from advising and representing them if they may be contributing to negative impacts through their activities, even if these are legal under national law. This considerably restricts the range of legal advice available to lawyers and thus the access to justice, because it is usually the question if negative effects are legal.

Exemption for lawyers' work imperative

The DAV renews its demand, already made with regard to the national German LkSG, that the special concern of the legal profession should be taken into account by excluding lawyers and other holders of professional secrecy from the scope of application of the draft directive, at least as far as mandate-related activities are concerned. This would be justifiable given that the legal profession, irrespective of their public function, unlike manufacturing industry, cannot be assigned to the high-risk area of human rights and environmental law. The legislator should also take this opportunity to examine whether similar provisions should be made for other liberal professions, which, although not part of the administration of justice, are nevertheless holders of professional secrecy.
An exception is for example also provided for in Art. 3 para. 3 b of Directive (EU) 2019/1937 of 23 October 2019 on the protection of persons who report infringements of Union law (Whistleblower Directive). Unlike in the latter, however, in the present case not only the lawyer's duty of confidentiality, but also the free choice of lawyer and the independence of the legal profession from its clients as an essential prerequisite for functioning as an organ of the administration of justice must be safeguarded. This can only be ensured by a complete area exemption for mandate-related legal activities.