
Public Consultation by the EU Commission on Sustainable Corporate Governance

Proposal for a Directive of the European Parliament and of the Council on Corporate Sustainability Due Diligence

Statement by the German Industry Association SPECTARIS

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Introduction

SPECTARIS is the German industry association for optics, photonics, analytical and medical technologies, representing more than 400 companies. We appreciate the opportunity to provide feedback regarding the EU Commission's proposal for a directive on Corporate Sustainability Due Diligence (CSDD).

SPECTARIS generally welcomes the initiative by the EU Commission to tackle and address human rights and environmental due diligence within supply chains and the effort to create a harmonized regulatory approach. From our point of view, the proposed directive is a valuable contribution and complements the EU's various sustainability initiatives.

In order to ensure that the goal of harmonisation can also be successfully implemented in practice, we would like to bring a few remarks and challenges to the Commission's attention where practical realities of supply chain set-ups do not go together with the proposal and hence run contrary to the Commission's goal of harmonisation. We would also like to highlight areas where further clarification would be needed, when finalising the proposed directive.

In particular we would like to recommend the following three areas for improvement

- 1. Consider already existing due diligence legislation on national level and ensure more harmonisation**
- 2. Limit comprehensive due diligence requirements to tier 1**
- 3. Limit the due diligence requirements to upward activities along the value chain due to the complexity of value chains and the legislation already being in place to review end-users and customers**

Remarks in detail

Aim of harmonisation versus national fragmentation

While the European Commission is currently working on the proposal for a pan-European legislation, it needs to be noted that at present many countries such as Germany, the Netherlands and France have already passed their own legislation at the national level. There are also similar plans in Belgium, Spain, Luxemburg and Sweden to introduce national legislation, while other EU member states are still without an overall plan for developing due diligence obligations.

In their proposal, the EU Commission has clearly stated the goal to avoid fragmentation in the single market and to create legal certainty for businesses and stakeholders with regards to expected behaviour and liability. However, the goal of harmonisation is currently not reflected in the proposal. SPECTARIS considers it reasonable, if an EU initiative in this field would have taken into account existing legislation and used them as a benchmark.

As the proposal is set out as a directive, it will be the 27 EU member states' responsibility to interpret, implement, enforce and sanction the provisions of the proposal on a national level. Additionally, the proposed directive refers to an annex which specifies the adverse environmental impacts and adverse human rights impacts relevant for this directive

without further explanation. In consequence, the EU member states will also have to apply and interpret the provisions of the directive against several ILO conventions, the Universal Declaration of Human Rights and the Paris Agreement.

Due to the varying approaches taken by the individual member states, differences in how the provisions of the directive will be applied in practice are to be expected. SPECTARIS and its members fear that the progressive step taken by the commission to propose a European legislation on Corporate Sustainability Due Diligence will not lead to harmonisation and a level-playing field, but rather to market fragmentation. Contrary, companies would have to adhere to several different interpretation and reporting requirements across the EU member states and will face additional administrative burdens.

Generally, directives provide a lower level of harmonisation than a regulation. The EU commission has over the last years been strongly in favour of regulating with the means of "Regulations" to ensure a high level of harmonisation and to guarantee a level-playing field. To avoid problems of the past caused by different interpretations as well as delays in the implementation of the previous directive in the member states and to increase legal clarity in regards to the scope of application and definitions, the EU-Commission is for example currently working on a proposal for a Regulation of the European Parliament and of the Council on machinery products, which have previously been governed by a directive. It is therefore, questionable, why the Commission has chosen a directive to regulate corporate sustainable due diligence, which bears the risk of market fragmentation and leaves much room for legal interpretation and hence legal uncertainties for affected companies.

In regards to the proposed CSDD directive, SPECTARIS has the following requests in order to prevent market fragmentation:

- **Harmonisation with the already existing and upcoming national and international principles, guidelines as well as other EU policies which address supply chain due diligence.**
- **Guidelines for member states with exact definitions of all the terms and interpretation guidelines concerning the CSDD directive.**

Subject matter and scope of the proposed directive (Article 1 and 2)

Companies within the scope of the proposed directive will have the obligation to conduct due diligence along their entire value chain operations, which means upstream and downstream. SPECTARIS deems the scope of the directive as too broad, as the directive also obliges companies to perform due diligence not only for established business relationships but also for indirect business relationships along their entire value chain.

To monitor and conduct due diligence beyond tier 1 is first of all legally difficult, as there are no contractual relations or legal grounds between parties upwards and further down the value chain. The SPECTARIS high-tech industries consist of a complex web of global supply chains.

In terms of the setup of the value chains of the SPECTARIS members, there are certain practical challenges we would like to highlight for the commission:

■ **Lack of transparency and access to information further up the value chain**

Our member companies generally exercise a high level of diligence and a risk-based approach when sourcing and selecting suppliers. Many of them are additionally members of initiatives such as the Responsible Business Alliance and adhere to their regulatory standards. Within the first-tier and where possible into the next tiers our members conduct an in-depth screening of their suppliers and their suppliers' business partners. Obtaining documents, such as certificate of origins or suppliers declarations to assess which business partner of a supplier provided which component becomes however increasingly difficult when moving further up the value chain.

The high-tech products of the SPECTARIS industries consist of many small electronic components and raw materials. The number of components range from 15 components in a rigid endoscope head to approximately 5.000 to 10.000 individual components in other high-tech products. These components and assemblies are usually either supplied by several hundred different suppliers or purchased centrally through one or several central purchasing organisations and suppliers. These central purchasers on their end source from different suppliers or other purchasing organisations. Purchasing organisations usually provide a supplier's declaration consisting of a commercial invoice, a delivery-note or any commercial document which clearly identifies the goods. Further information about the respective supplier of each item and the origin of the item are usually not stated and are often not revealed by the direct business partners and consequently difficult to obtain.

■ **Due diligence challenges when sourcing recycled raw materials**

The demand for raw materials such as rare earths will increase in the foreseeable future. This will give the sourcing raw materials through recycling more importance. At SPECTARIS, we are currently working on a project to establish a recycling scheme for single-use laboratory plastics and to return these plastics to the material sourcing cycle. As the raw materials are recycled, it is not possible to track the exact origin of the raw material. Using recycled materials would therefore prove to be challenging for conducting due diligence as outlined in the scope of the directive. This would be contrary to the aim of businesses to source more responsible.

■ **Considerations from the SPECTARIS industries with regards to due diligence down the value chain**

Another main concern for the SPECTARIS member companies is the fact, that the proposed directive requires them to conduct due diligence not only for their suppliers, but also for their customers. EU legislation such as the dual-use regulation, the various EU sanctions regulations or the money laundering directive already require companies to conduct a thorough screening of their direct customers and often also the end-customer. Compliance with these regulations is monitored through custom and foreign trade audits throughout the EU.

Given the complexity of value chains of our industries, sufficient national and EU legislation in place when it comes to screening down the value chain and the administrative burden for companies of following another

directive with regards to customer screening, the scope of the proposed CSDD directive does not need to extend to activities further down the value chain. Besides this, the influence of the European company is limited when the customer decides to resell or dispose the good.

As SPECTARIS also represents the German medical device industry, we would also like to highlight that health care companies additionally have a humanitarian and ethical obligation to continue supplying their products to state hospitals in conflict regions or to NGOs active in countries ranked low on the United Nation's Human Rights Index. The scope of the proposed directive currently does not allow for exemptions for humanitarian supply and medical devices. An exemption for humanitarian and medical causes should therefore be included.

The requirement to monitor compliance with due diligence obligations by all actors in the entire value chain (incl. customers and utilization of the products) leads to a massive administrative, personnel and financial burden on already strained supply chains. It is also questionable to what extent the measures to be taken are suitable and effective for achieving the overarching goal. We would also like to highlight that value chains are also characterized by small and medium-sized enterprises that have no realistic means of monitoring their entire value chain and influencing third parties abroad.

Based on the above-mentioned examples SPECTARIS would recommend to:

- **Limit comprehensive due diligence requirements to direct suppliers/ established business relationships (Tier 1)**
- **Introduce a risk- and occasion-based approach with clear definitions and limitations with regards to depth of the due diligence analysis with regards to indirect suppliers**
- **Exclude due diligence obligations for raw materials sourced from recycling or simplify the obligation to provide evidence of origin**
- **Remove the obligation for customer due diligence in general due to other regulations governing these issues being in place**
- **Exclude humanitarian and medical causes from the customer due diligence provisions.**

Definitions (Article 3)

The definitions stated in the proposed directive remain in many areas very vague and allow for a considerable amount of interpretation by the EU member states. Some terms such as "adverse impact" or "stakeholder" are not defined at all throughout the whole proposal, whereas the definitions of "appropriate measures", "established business relationships", "principal risks" or "principle adverse impacts" are too vague in their definitions. Additionally, the reference to several soft law texts and multilateral declarations listed in the annex make it increasingly difficult for companies to access, what their obligations are, especially as some of the legislative texts are not directed at companies but rather at states.

- **To achieve greater harmonisation in due diligence and to create a level playing field, it is therefore necessary to sharpen the definitions and clarify the obligations of companies.**

- **To facilitate the reading of the directive, it would be beneficial to include all necessary definitions in Article 3 along with the specific obligations and remove referrals to the annex for further references.**

Due diligence requirements (Article 6-8)

The ensuement of identifying actual and potential adverse impacts, preventing potential adverse impacts and bringing actual adverse impacts to an end rests in the responsibility of the member states. According to the proposal, the member states will also be responsible for ensuring access to appropriate resources for companies to identify adverse impacts. Furthermore, terms such as “appropriate measures” which are to be used by companies to identify and prevent actual and potential adverse impacts, are not further defined.

- **Directing this responsibility to the member states could create an uneven access to information and thus an uneven level-playing field throughout the EU. To ensure that all EU companies and third-country companies within the scope of the directive adhere to the same standards and level of due diligence, defining appropriate measures, standards and quantitative as well as qualitative tools to measure due diligence should be provided on EU not on member state level.**

Complaints procedure (Article 9)

The complaints procedure in Article 9 obliges companies to provide the possibility for affected persons, trade unions and other workers’ representative as well as civil society organisations to submit complaints to them when they have legitimate concerns regarding actual or potential human rights or environmental impacts with respect to their own operations, the operations of the company’s subsidiaries and value chain.

As the scope of the persons and the reasons persons or organisations can submit complaints is very broad, the personal and financial resources companies would need to provide to keep the grievance mechanism in place will be unreasonably high. Extending the scope to the entire value chain and including potential human rights or environmental impacts to the scope will increase the difficulty for companies to maintain the complaint procedure. It also needs to be noted that it is in some cases extremely difficult for companies to obtain certain information needed to answer to the complaint, especially when there are no legal relations with the company and the parties the complaint requests deals with.

Keeping in mind the resources companies can provide to maintain a complaints procedure SPECTARIS would recommend to:

- **Limit submitting complaints to actual adverse human rights and environmental impacts with respect to the company’s own operations or the operation of their subsidiaries.**
- **Provide a list of civil society organisations by the European Commission which are eligible to submit complaints.**
- **With regards to meeting with complainants, there should be a tier-level approach and objective criteria set by the European Commission, not the member states, under which circumstances meetings between company representatives and complainants should take place.**

Monitoring (Article 10)

Under this article, companies are required to perform supplier assessments and business relationship assessments of their own operations and their subsidiaries operations every 12 months. Given the large number of suppliers of the SPECTARIS members and the currently still existing travel restrictions due to Covid, an annual review of all suppliers will be difficult and extremely expensive to realise in practice.

We would therefore recommend to:

- **Align this requirement with the international frameworks such as the OECD guidelines and existing industry practices and guidelines**
- **Allow for desktop assessments of suppliers, especially when travel restrictions to sourcing countries such as the People's Republic of China exist.**
- **Implement a risk-based approach for supplier assessments including a risk catalogue for companies under which circumstances the EU Commission would deem a supplier assessment relevant and necessary.**

Combating climate change (Article 15)

Article 15 imposes further obligations on companies that meet the thresholds set out in Article 2(1)(a) and Article 2(2)(a). According to Article 15 of the proposed directive, they must additionally meet the following requirements:

- Adoption of a plan to ensure that the company's business model and strategy are in line with the Paris Climate Agreement limiting global warming to 1.5 °C (Article 15 para. 1);
- Inclusion of emission reduction targets in the corporate plan, where climate change has been or should have been identified as a major risk or impact of the company's operations (Article 15(2)); and
- Consideration of a director's contribution to the fulfilment of the above duties in determining the director's variable compensation (Article 15(3)).

From SPECTARIS point of view, it is of great importance that the EU is working ambitiously on their climate policy. However, we doubt that the current proposal on Corporate Sustainability Due Diligence is the right framework for setting emission reduction targets, as the present proposal should focus on human rights and environmental due diligence.

In order to avoid an inconsistent regulation and several legislative acts to consider, we would recommend to:

- **Consider climate aspects and climate targets in the respective separate legislative proposals.**

Enforcement (sanctions and civil liability)

The Proposed Directive envisages enforcement by member state administrative authorities, with fines for non-compliance and specific directors' duties in relation to human rights and environmental law. The proposal would also introduce a new civil liability regime, which goes beyond existing legislation on national level, to allow victims to sue companies for damages and for harm, which could have been avoided by proper due diligence measures. The

proposal also provides that civil liability arises even, if the law applicable to the claim in question is the law of a non-EU state.

A company is also not liable for damages arising at the level of an indirect business relationship, if the company has obtained contractual assurances of compliance with the company's policies and action plans and takes appropriate measures to verify compliance.

With regards to civil liability SPECTARIS is concerned that the CSDD directive has very far-reaching and largely unpredictable consequences on companies, as the proposal suggests a new legal term along with a multitude of undefined legal terms in the definition of potential liability. Besides this, it remains unclear what "reasonable measures for civil liability" are.

SPECTARIS is of the opinion that companies should only be liable for their own activities in the supply chain, not for those of their business partners or their suppliers. Introducing the concept of civil liability for entrepreneurial activities of third parties goes beyond reasonable and manageable responsibility for companies.

We would recommend to:

- **Exclude civil liability and focus on sanctions and administrative enforcement mechanism.**

Given that the definition of sanctions and enforcement will fall into the responsibilities of the member states, there is a risk of inconsistent enforcement throughout the European Union. Article 20 states that the sanctioning rules shall be based on the turnover of the company. However, no further details on the definition of turnover are provided in the proposal. It therefore remains unclear what responsibilities a parent company would have in terms of CSDD, when one of its subsidiaries breaches a provision. Will the turnover of the subsidiary, the parent company or of the entire corporation be considered when calculating the fine?

In order to prevent inconsistent enforcement or different levels of enforcement, we would recommend to:

- **clarify the definition of turnover**
- **define at EU-level the limits related to the companies' turnover in relation to pecuniary sanctions in Article 20 (3).**

Director's duties (Article 25 and 26)

Article 25 and article 26 of the proposal contain rules on director's duties and oversight which will need to be implemented by the 27 member states. Throughout the European Union we have significant differences in corporate governance models, which will create challenges when determining which legislation is applicable especially for companies which have operations in more than one EU member state.

SPECTARIS would recommend to:

- **further clarify the responsibility and liability of boards and directors on boards and highlight which rules would apply especially in cross-border cases.**

Considerations for small and medium-sized enterprises (SMEs)

Although small and medium sized enterprises (SMEs) are not directly included in the scope of the proposed directive, SPECTARIS would like to highlight that especially in the high-tech industry many SMEs are part of larger companies supply and value chains and hence are still indirectly part of the scope. They could therefore be impacted by the directive provisions as contractors or subcontractors to the companies, which are in the scope.

We therefore welcome the effort by the Commission to put in place other supporting measures building on existing EU actions and tools to support due diligence implementation within the Union and in third countries, including facilitation of joint stakeholder initiatives to help companies fulfil their obligations and support SMEs impacted by the proposal.

However, we find the requirements of large companies towards SMEs to provide financial and compliance support for SMEs stated in Article 7 (4) as well as Article 8 (3) challenging for both sides. Providing assistance for SMEs cannot be placed on companies alone, as this provision creates a significant financial and non-financial burden for companies within the scope. Larger companies within the SPECTARIS industries often could have several hundred suppliers which are SMEs and which would need assistance. Additionally, this provision would also create an administrative and operational burden for SMEs, if they are required to adhere to the different requirements large companies as their customers ask them to follow. This could for example mean to supply information to a variety of different IT programmes, since every company will use different methods to monitor their due diligence.

To address these shortcomings, we would recommend to:

- **introduce a distinction between financial and non-financial support that is to be provided to SMEs by companies within the scope of the directive**
- **consider to delete the obligation for larger companies to provide support to SMEs**
- **set maximum requirements for SMEs or limit obligations for SMEs to provide information and clarify which documents need to be provided and which processes need to be conducted when SMEs are part of a supply chain so that they do not have to deal with a variety of different tools and approaches.**

Level-playing field and public tenders

Finally, we would bring to the attention of the Commission that a non-EU company is in scope only with its EU subsidiaries and the generated net turnover within the European Union, whereas the EU companies are in scope with their number of employees and worldwide turnover. This creates a gap and a disadvantage for companies active in industries, which rely on public tenders for business. The proposed directive will increase the administrative burden for companies within the scope but also for SMEs as part of the supply chains. These costs will in consequence be included in the company's calculation and hence in the product prices which will in consequence negatively impact international competitiveness. At the same time, the requirements for participating in public tenders throughout the European Union have not been amended.

Public tenders are often awarded based on the most costly-effective offer. CSDD aspects are often not considered, which could be a disadvantage for EU companies having to comply with the directive.

SPECTARIS would therefore recommend to:

- **Include compliance with the CSDD directive and CSDD as a criterion within public tenders throughout the European Union**

SPECTARIS is the German Industry Association for Optics, Photonics, Analytical and Medicinal Technologies. The association SPECTARIS represents more than 400 mainly small and medium sized German companies. The represented industries achieved a total turnover of around 78 billion euros in 2021 and employed around 331,0000 people. Our members are very export oriented with an average of two thirds of their products being exported.