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Session: ESG and Arbitration – Implication of the upcoming EU ESG reporting and supply chain requirements

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SPEAKERS NAMES:

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Abhileen

Good evening, everyone. Welcome to the second last session of the India ADR Week on 13th of October, Thursday. Today on the panel, we have four lawyers from different parts of the world. Our topic of discussion is much talked about and much needed to be talked about, in fact, ESG and Arbitration. On the panel, we first have Mr Robert Hunter. Robert Hunter represents corporations and states before international tribunals and advises on the law and policy of foreign direct investment. Robert has more than 35 years' continuous experience of complex international dispute resolution, with substantial periods in each of London, New York, and Germany.

In addition to his advocacy and advisory work he is regularly appointed by parties and institutions alike as an arbitrator, both in ad hoc proceedings and under institutional rules including DIS, ICC and LCIA. Robert has exceptional cross-cultural expertise and a dual qualification in England and Germany. The disputes in which he has been involved as counsel and arbitrator have concerned projects and contracts in four continents with seats of arbitration ranging from Singapore and Hong Kong, through Cairo and most significant European arbitration centers, to New York and Washington D.C. Robert is a long-standing member of the ICC Commission on Arbitration and ADR, a member of the Advisory Board of the German Arbitration Institute, a member of the Executive Committee of the MCIA Users Council and on the panel of arbitrators of the Beijing Arbitration Commission. He has been a senior consultant to the World Bank advising governments on investment policy framework as well. Welcome Robert.

Next, we have on the panel is, Dr Lars Kutzner. Dr Lars is one of Germanys leading lawyers in the field of corporate white-collar crime advise, compliance management services and conducting internal investigations. For more than 18 years he advises and assists his clients in navigating through national and international crises. He primarily advises and represents companies, and also represents boards of directors, supervisory boards and executives in all types of criminal and administrative investigations by supervisory authorities, tax and customs investigators, public prosecutors of courts.

Lars also defends and represents companies in national and international investigations, confiscations, in criminal proceedings and before parliamentary committees of inquiry. He advises

clients from all sectors but has a focus on clients from the retail & consumer sector as well as from the financial sector. Lars was admitted to the bar in 2004 and has been a partner at Osborne Clarke since 2022. Welcome Dr Lars. Next, we have on the panel is Dheeraj Nair from JSA. Dheeraj has been practicing as a lawyer since 2000 in all Indian in majority of the Indian courts and tribunals. He's appeared in twenty High Courts in India and conducted several arbitrations. He has been a partner at J. Sagar and Associates since 2009. He's also a qualified Advocate on record of the Supreme Court of India since 2008.

His core expertise is in making strategies and handling multifarious and complex litigations as well as domestic and international arbitrations. He has mediated and negotiated various settlements for a lot of his clients. Last, I take this opportunity to introduce you to the moderator for the session, Mr. Kanwar Vivswan. Kanwar advises clients in resolving complex cross border disputes. His practice focuses on international arbitration matters especially in energy, infrastructure, technology and post-M&A disputes. He has experience in representing clients across sectors in several large arbitration matters majorly under ICSID, ICC and DIS rules.

Kanwar studied law at the NLU, Delhi, and Humboldt University, in Berlin. After being admitted to the bar in India in 2016, he joined a major Indian law firm in Mumbai where he advised clients on resolving complex civil and commercial disputes before Mumbai courts. Kanwar regularly publishes on topical issues on international arbitration and teaches international commercial arbitration as a guest faculty at the National Law University, Delhi. He is also a member of the DIS40, Young ICCA, Young ITA. Kanwar has been a part of the international arbitration team and Osborn Clarke since 2019. And I hand it over to Kanwar to take it forward. Thank you.

Kanwar Vivswan

Thanks a lot, Abhileen. Hello, and welcome to everyone to this session on ESG and Arbitration. As Abhileen kindly introduced, I'll be the moderator for this event. And I will start with the goal that we have in mind for the session. Our goal is that, by the end of this discussion, we introduce to all of you, the audience, the implication of the upcoming EU ESG reporting and supply chain requirements, that especially their impact on Indian businesses. Now, many of you might be aware that there's this range of ESG regulations, which are being drafted and discussed at a global level.

Now, we have three reasons why we have chosen this topic and this forum. The first is that the risk arising, as we see it arising out of these regulations can be far reaching and there's need to be managed not only by the company, which is directly targeted by the regulation, but as well as entities which interact with it. Second is that the stringent nature of these ESG regulations, and the consequent ESG clauses, which we will discuss later, are not only novel and complex, but they are untested as well, and they're likely to give rise to a lot of disputes, and it would be interesting to see how they will be interpreted and applied.

And third reason is that since we are in the India ADR Week, we will discuss whether arbitration is the best mechanism to solve such disputes, which would come out of the ESG regulations as well as the ESG clauses that we will discuss later. Before I hand it over to Lars, a few housekeeping rules. The structure of this discussion is a structured format discussion, which means that I will give the speaker’s uninterrupted time before we enter into a discussion to present their views. And the order would be as a slightly different from as was introduced by Abhileen. So, Lars would be the first speaker, followed by Robert, and then Dheeraj.

If you have any questions, please use the Q&A function in the Zoom app. Depending on the question, either I will take it up during the discussion, or I will put it all together in our dedicated Q&A session at the end, and this session would be closed by closing remarks, which will be in the form of recommendations from our experts. Now I, before giving the mic to Lars, I'm sure that many of you have heard about the term ESG regulation. Now, Lars, could you please break down this term for us from a European perspective, the background of the EU regulations, as well as take us through the most relevant provisions of the complex, European ESG legal framework. And while you do that, I would ask you to touch upon the specifications and the challenges of doing ESG compliance in European Union.

Dr Lars Kutzner

Thank you, very much and good evening, everybody. In Germany, it's just slightly afternoon. Yeah, thanks for the questions Kanwar. So, ESG is a very wide topic, and I like to focus today on what we call CSRD and CSDD, which is the Corporate Social Responsibility Directive to be issued by the

European Union as well as it covers the Corporate Social Due Diligence Directive, which is still a draft, and not in the end of the parliamentary process in Europe.

So, looking at ESG, it is quite relevant to understand that the political background about it. So, there are a lot of stakeholders, and the European Union, the local governments and of course, a lot of pressures put by NGOs on this topic. So, throughout the years, there were a lot of bilateral or multilateral agreements that were in the legal process. So, we had the German sustainability finance strategy, we have the EU Green Deal, the biodiversity strategy, the UN Agenda 2030 Climate Change Agreement, and so on, so forth. The idea was to have a more sustainable economy that prevents, mitigates and manages the negative impacts of the company's environment in human lives.

So, looking at the EU roadmap, one has to understand that the CSRD and CSDD I'd like to talk today about is not a low standing act. So, what we talk about is, for example, low carbon benchmark regulation, sustainable refinements disclosure regulations and taxonomy regulations that are already in place, and that affect the payments community. So, this is already in place as part of the financing and funding. So, what we have on the Corporate Sustainability part is we are lost on the audit side, and we are lost on vigilance side, and this gap is filled by these two directors. So, the relevance of the CSRD is that we try to establish mandatory audit requirements. How compliant is a company in terms of ESG regulations and does the company pose the risk to ESG aspects?

Having that in mind, we already had non-financial reporting in the EU, but we saw that too small a number of companies were actually obligated to be audited or to disclose these facts. And when we look at the reports, the quality was quite insufficient. So, the CSRD changes these things. So, the recipients of the new CSR reports are not only the stakeholders or the shareholders we had before, but it's more of a 360-degree approach. So, we look at capital markets, we look at consumers, we look at with business partners, we look at the media, analysts and NGOs. So, the goal is improving the accuracy of the information base, and the instruments it's called the legal obligation to disclose information regarding these undertakings, the sustainability matters. That is for the CSRD.

The CSDD is a directive, which establish certain obligations to mitigate potential ESG risks, on the human rights side as well on the environment side, and the status of time that the European

Parliament passed this initiative through resolution and sent requests and recommendations with Commission, and the resolution with a resolution of Parliament called upon the Commission to draw up a draft law and the Commission draft was postponed for more than, I'd say from all other ones. Of course, the risk into businesses, and the Commission now has presented after a lot of months, and extensive proposal with more than 70 Recitals and 32 Articles

So, it's quite a demanded graph. We have here and now we get into a little bit more of detail. So, you might know ESG consists of E, S and G meaning Environment, Social and Governance. So, for every part of the ESG, the CSRD establishes certain European Sustainability Reporting Standards and so called ESRS, and these are reporting manuals delegated acts of the EU Commission and we have one is a report topic and in the CSRS's, we have a mandatory audit requirement that have to be verified by an independent and qualified auditor. So, it could not be every auditor, it must be qualified.

In this ESRS we have some years of access. For example, in EU we have climate change, pollution, resource use, water marine resources, biodiversity ecosystems, and as we have workforce, supply chain workforce issues affected communities and consumer and end consumer issues. And in G we have, structured and structure and qualification of governance bodies, business conduct, business ethics, anti-corruption, bribery and compliance management.

So, within each of these four or five groups with an E, S and G we have subgroups together, meaning its benefit and business models governance, impact risk, opportunities, policies, targets, action plans, resources and performance metrics. And we have and so every company has to respond to each of one of these different topics, subtopics and sub-sub-topics. For example, when we look at the ESRS D1 for climate change information so regarding strategy and business model, the ESRS states that the company has to disclose its plans to ensure that its business model is compatible with the transition to a Climate Neutral economy.

Regarding governance, we have, the company has to disclose whether and how the remuneration schemes for the managing members include climate-related performance indicators. Regarding performance metrics, for example, they have to disclose the gross scope one GHG of Greenhouse Gas emissions in metric tons of CO_2. So, you see, what we have here in EHRS on the audit side, it

is very specific, it is very intense. And till now, we were able to say, well, we can get out of, so we don't have to report it because it's not material. Before the new CSRD everybody said, well, it's not material because it's not monetary material from the monetary perspective.

So, for example, if we have an environment issue, and maybe the damage would be €1 million or €2 million, but we have a balance sheet some balance of value of the company of more than €4 trillion, €3 trillion or €1 billion, just give a number. This is not material for the company, just to be sure there. So, this was the question. And what changed, actually is that we've changed the concept of materiality. Currently, we have a concept of accumulated materiality, that means when something comes up, it must be financial material as well as in pigmented or in pigment too. So, it could have a hard impact on the environment, but it's not financially material or the other way around. So, then it doesn't have to be reported.

Now prospectively, we will have alternative materiality, meaning it could be financial material, or it could have an impact materiality. It means maybe not financially material, but it will have a strong impact on E on S, and G, and then it has to be reported. So, the legal presumption is that each report has information is first of all material, and the exemption from the presumption of government clarity, if any information is not material for the company or sustainability matters, there must be certain grounds. Well, will this very strict reporting start?

Well, currently, the European Parliament will be in session in one week on the 17th, almost one week on the seventh of October, and it is assumed that this law will be passed to the European Parliament as well as the EU Council, as the Council of a member states of the European Union will also pass it on the same day. Of course, the draft they're discussing was negotiated between the council and the parliament. So, this is a bilateral graph. So, it will not be questioned anymore, it's highly impossible with it will be requested.

So, that will mean that for so called large companies meaning more than 250 employees, or more than €20 million balance sheet or with more than €40 million net turnover, two of these three have to be met, two of the three requirements have to be met. Then, your so-called large company as long as you have as you've counted under EU law or a national law under the inside the EU. Then as for example in Germany and GmbH have as a subsidiary of an Indian company. And who meets

these two of these three requirements will be obliged to file these reports in 2020. Interim credit six for 2025 for the first.

So, that's the timeline. And of course, there must be something that can be audited. So, we have about two-and-a-half years now to amend processes, to implement processes, to implement structures, plans, teams, whatever you ever is required, for example, to meet the requirements of a series D. So, it's not a long shot. It's quite intensive work and small, midsize companies can come afterwards, but for the subsidiaries who meet these requirements and are founded that National Law and the EU, inside the EU this obligation starts in 2026. The PR stock listed company then it's already starts in 2025 for the reporting year 2024. So, you have only one-and-a-half years to do.

When we look at the CSDDD and Robert later on will talk about the national law, the German national law. The CSDDD is a directive still in draft, it's not in Parliament, we're still discussing that we think maybe that it will, that we will have an announcement by the European Council end of this year how it sees this draft and then I’ve to go get back into negotiations next year and it will most likely be set into force in 2024. Of course, parliamentary processes are parliamentary processes, and it could also be later, but 2025, 2024 is year we're expecting the draft to get into force.

So, the CSDDD stipulates certain obligations for companies. So, the obligations are, for example, companies have to identify, prevent, and or mitigate the adverse impact of activities on Human Rights and on the Environment and be accountable for them. So that is, what is also set in there is that there's a possibility for litigating. So, the member states if we transform this direct to International Law, have to implement a possibility to litigate companies for not meeting their duties, which often have to be of course transformed into international law.

So, what are the companies that are obliged? So, first of all, there are two groups. Group One are EU companies that have at least 500 employees and €150 million plus in net turnover worldwide. So, these are companies founded under national law inside the EU 500 employees more than €150 million plus net overturn around turnover worldwide. The Second Group of EU companies with more than 250 employees, the net turnover of €40 million worldwide and that achieved at least 50% of that net turnover in a defined so called high impact sector. So, you will ask okay, what on earth is a high impact sector, so, there are three of them.

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The first is the manufacture of textiles, leather related products, including footwear and the wholesale trade of textiles, clothing footwear, this is one high impact sector. The second one is agricultural, forestry, fishery, including agriculture, manufacture of food products and the wholesale trade of agricultural raw materials, live animals, wood, food and beverages. And the third one is, the extraction of mineral resources regardless from where they are expected, including crude, petroleum, natural gas, coal, lignite, metals, metal ores and so on and so forth. I could go on this is a long part in terms of metals. So, you see these three sectors really drive the CSDDD and also the ESG laws in the European Union.

So, then what about non-EU companies? So, for example, are you also obligated under the CSDDD if you do not have a company inside Europe, but you do business in Europe as a non-EU company? Yes, you are. Non-EU companies active in the EU with more than €150 million-plus turnover in the EU in the financial years preceding in the last financial year as well as €40 million-plus, but not the more than €150 million turnover and 50% of these €40 million and the so-called high-risk sector are obliged to fulfil these obligations thus far.

So, if you have a subsidiary Group 1 or 2 may apply, if you do not have subsidiaries, but do business inside the EU and fall under these €150 million-plus, up €40 million up to €150 million and 50% in the high-risk sector, then you will be obliged to fulfil these duties. So, what are the main duties? Of course, directly applies to companies, subsidiaries, they will change directly and indirectly to establishments and business relations, also PE are included. We've already talked about the due diligence duties and companies in Group 1 are also required to have a plan to ensure that the business model and strategy are compatible with the limited of global warming to the 1.4-degree goal due to the Paris agreement.

Moreover, the company's management for all groups is to be responsible directly and personal responsible for the compliance with the due diligence duties. So, it's not only a company issue, but it's also a personal management issue. And bonus payments can also be made contingent on compliance with these duties. So, any reviews of the restriction assessment, other measures are required. Companies are also required to report on matters covered by the directive and publish an

annual statement on the websites. Breaches of these duties in supply chain, for example, are subject to possible Civil Law liability.

The Civil Law liability presupposes that the damage could have been identified, prevented mitigated and by means of suitable due diligence prevent measures. EU individuals while injured by business operations, Unions and all NGOs are to receive the option of bringing actions for damages against companies before member states of the courts or to complain about these things. And the opposite of complying with its digital Institute is in the form of contractual assurances is possible. But there's an exception. And this is very, very important.

This, if it was unreasonable to expect that an action actually taken inside supply chain would be adequate to prevent mitigate and bring to an end, minimize the extent of the adverse impact, then the company in Germany has to take care for itself. So, it could be **[Inaudible 00:26:28]** only obliged for your first level supplier, so you could be obliged to mitigate the risk up to the very beginning of the supply chain. So, this is important and of course, it's a totally different to what normally happens inside here.

Kanwar Vivswan

Thank you very much, Lars, for that. Now, we have understood the broad legislative framework of how the EU wide ESG directives work. I now want to direct the discussion more towards Germany and this is with the background that I was asked a question yesterday by many people at the MCIA dinner, which is that why should Indian companies be concerned with a German or a Europe wide regulation? So, Robert, with that question in mind, could you introduce the key provisions of the German law in terms of how they're likely to impact Indian companies and the contractual requirements and the downstream purchases in India or in Germany how would they be specifically affected?

Robert Hunter

Thank you, Kanwar. Well, first of all, why are we concentrating on the German Act? There are two reasons. The first is that it's coming into force on the first of January next year, so it's imminent and

will have immediate teeth. And the second is that it is an indication, a strong indication of what kind of laws are going to follow from all EU member states once the CSDDD has come into force as a directive with one important embellishment, which I'll touch on in a moment. So that's why in the next 10 minutes or so I'm going to concentrate very quickly on three core elements.

The first is the scope, what is the scope of application in terms of its object, and in terms of those enterprises affected, I'll talk about some of the principal obligations very quickly and very briefly, and then the principal means of enforcement. Those three elements naturally then lead into a clearer prognosis of what these obligations are going to mean for Indian companies having anything to do with initially German and then more broadly, European enterprises in a supply chain and relationship in the imminent future. And that will be a good starting point for Dheeraj's talk.

And we aim then to put in that context, what the implications will be for dispute resolution, and arbitration in particular. So, in terms of scope, it's very broad and intentionally so. The scope of the German Supply Chain Act is to apply to all products and services of a German enterprise, essentially, including and listen to this because it's important all steps in Germany and abroad, so everywhere in the world, that are necessary to produce the products and provide the services starting from the extraction of the raw materials to the delivery to the end customer.

When it includes the actions of an enterprise in its own business area, both within Germany and abroad, and the actions of direct and indirect suppliers, it could hardly be broader and that's intentionally so. As Lars explained the political background to this, it is an economic term to force companies to internalize the cost of environmental and human rights related actions. Based in the German case, at least, specifically on 14 International Conventions to go back nearly 100 years to the first one being an International Labour Organization, convention of 1930.

The strong feeling is that in the current environment, the obligations and these conventions have not been observed nearly enough, and the costs need to be internalised in order to give these obligations realty. And to do that, we have this extremely broad sweeping scope of the Supply Chain Act. The object of the legislation is that companies who are under it should exercise due regard for the Human Rights and Environment related due diligence obligations, for present that does not cover every ESG obligation, the emphasis in the Supply Chain Act is very much on Human Rights obligations.

Also, the Environmental obligations are the main focuses within the Human Rights areas such as right to water and so on, and to a safe living environment that the environmental aspects are based, rather specifically on certain hazardous chemicals and so on. But I'm sure this is not the end of the story, but it is the beginning of the story and the one with the most immediate implications. Why would it have implications for Indian companies? Well, that is easy to see, if you look at the obligation on the Enterprise is directly subject to it, which are effectively mid to large scale organizations with operations in Germany.

As from January it would apply to enterprises with 3000-plus-employees in Germany as from a year's time to organisations with 2000-plus. So really a very, very large sector of the economy. There are many obligations, I'll concentrate on the four, that carry the biggest penalties for non-observance. To give you an indication of where the focus of attention from German enterprises dealing with you is likely to be. The first obligation is to create an effective risk management system aimed at the particular rights envisaged or focused on in the Act. What does effective mean? It means a management risk management system that makes it possible to identify and to minimize Human Rights and Environment related risks and to prevent and or minimize violations.

If the enterprise has caused or contributed to those risks or violations to anyone listening in or watching this congress with a tool and litigious mind, they will realize that there's a great deal that can be done with that definition, in terms of applying its scope to any particular enterprise. So, it really does have teeth. The second obligation is that an enterprise must implement preventive measures, those kinds of measures, and this is of particular relevance. The first one, I think, to any company in a supply chain outside the EU, the first kind of preventive measure would be contractual assurances.

German enterprises are going to be imposing contractual obligations up their supply chains to ensure that they themselves can meet their obligations in Germany, they will consist of training, they will consist of contractual control measures and risk-based implementation and there's an obligation to provide a complaints procedure up the supply chain as well, which is accessible to all. The third obligation I'm going to mention, it's an obligation to take appropriate remedial action to prevent, end

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or minimize violations. The scope of those is, again, endless and broad, but they would include things like joint action plans joint that is between the enterprise and upstream suppliers.

Sector initiatives, I think that's a really ambitious, but nonetheless real goal, if a particular violation requires a broader, sectoral initiatives and that is an obligation that has to be undertaken. There's another appropriate remedial action is temporary suspension that will have particular relevance to the disputes field and ultimately termination. The Act requires a company an enterprise to effect termination. Basically, as a last resort, where there's a serious violation, there's been no remediation, and there is no less I mean, severe means to exert influence up the supply chain.

The fact that that's the kind of threshold, the bottom-line threshold in the Act in terms of a liability to penalty for an enterprise doesn't mean that that's going to be the threshold in the contractual putting up as its obligation, one might expect to see lower thresholds than it being the least or where there's no less severe measure available. And then, the final obligation I'd like to mention there are more is that even as regards indirect suppliers, if there are actual indications and not proof, but actual indications suggesting a violation, then one of the obligations is to draw up a prevention concept. And a failure to do so is also a breach. Now that again, is going to be very broad.

For instance, it would be quite easy, I think, for an NGO, to bring enough detail to the attention of German enterprise to satisfy the threshold of an actual indication suggesting a violation. Now, all four of the obligations I've mentioned, are the highest penalty obligations. So that brings me naturally on to enforcement as a very last few words, before I hand over to Dheeraj. The kinds of enforcement envisaged is also broad and hard hitting, there's an administrative power for the German authorities to summon people to enter premises to inspect documents for the purpose of enforcement. German authorities can order a correction, a corrective plan, they can even require specific action.

And I was discussing with Lars earlier, that's not in fact, the usual EU way, it's going to be quite interesting to see how that's enforced in practice. But that is, if you think about the kind of remedial measures I've mentioned, then there is very clear direct action that the German authorities can order an enterprise to take to give this directive teeth. There are funds, they range from €100,000, up to €800,000, all four of the obligations I've mentioned, can carry the maximum penalty, or for bigger enterprises up to 2% of average annual turnover, that's a big fine. There's a power to exclude

offending enterprises from public contracts. At the moment, the German Act explicitly excludes it being used as the basis of civil liability.

But that will change once the European directive comes into force, as a directive requires member states to provide for civil liability resulting from breaches. So, I will stop there, the intention was to set the scene for Dheeraj to be able to put the kind of obligations which you can readily up see will be imposed the supply chain into Indian companies and into Indian subsidiaries, to see how that compares with the existing regulatory framework. And I hope then we'll have time for discussion about what Indian companies might now wisely think about doing, and what the implications in particular might be for dispute resolution and arbitration in particular. So, thank you, Kanwar, I'll be back on that.

Kanwar Vivswan

Thanks for that Robert. I heard you mentioned that there are upstream obligations, as well as obligations between different partners within the supply chain. Before moving on to Dheeraj, I'll quickly take a question from the audience, which says that most of the obligations in the ESG space come from the regulators or the state, how do you see disputes between private parties here, and I'll take the Dheeraj's view on this question as well later.

Robert Hunter

Okay, thank you. Well, it's true the immediate regime of the German Supply Act is aimed very much at state regulation and fines. But it's pretty obvious that in order to observe their obligations, and in order to avoid fines in particular and possibly also by being subject to explicit authority to a regulatory order to undertake measures, that the obligations in the Supply Chain Act are going to be passed contractually of the line to direct and ultimately to indirect suppliers and subsidiaries. And the scope for disputes, I think Dheeraj is going to talk about this in particular, but the two most obvious scope, areas of scope for civil disputes are going to be in the M&A area in terms of breach of warranty, and in supply chain disputes. And each of those has different risks and different implications for dispute resolution and arbitration.

Kanwar Vivswan

Thanks for that, Robert. Now, we have understood the reason why these laws are coming into place and the processes that the businesses need to put in place. I would now like to turn to the Indian perspective on this. And a little background about the Indo German business and trade equation at the moment. Indian corporate entities have a lot of investments in Germany at the moment to the tune of €6.5 billion and there are almost 200 Indian companies operating in Germany and more than 1700 in German companies in India and countless number of suppliers, who from India supply raw material or products to Germany.

Now, with that background Dheeraj, how do you see the ground level implication of these directives and German national law and from other European countries from an Indian perspective, in light of what Lars and Robert said, and while doing that, probably you can talk about the existing equivalent laws in India and where do you see the role of arbitration in it, as well as the kinds of disputes that we can anticipate.

Dheeraj Nair

Sure. Thanks, Kanwar, Robert and Lars for updating us and actually enlightening us, on this new legislation which is coming up which I believe a lot of Indian manufacturers and suppliers will probably view it as very harsh and to the extent of being onerous considering the landscape that India operates in. So, as you correctly said, Kanwar, we, India is a very-very key supplier to several German companies. We are in pharmaceuticals and what Lars was mentioning about prefabricated chemicals, textiles and several other such industries, where India is a very key supplier to Germany. And considering the thrust that the government of India is putting on Make in India, we are going to be seeing a lot of action in the manufacturing sector.

And why it is important to understand how the manufacturing sector is going to get impacted with this new particular legislation, which is coming up in Germany soon is because two key aspects of this statute, which we heard are about Human Rights violations and environmental aspects. Now, both these issues are very-very prevalent in India, when we look at the Indian framework, and why I say so, is primarily because, and the question that you took actually Kanwar is so apt for the Indian

context, because in India we still do not have one regulatory framework governing the ESG issues. So, it's all divided into separate statutes.

So, you have for environmental compliances, you have the Environment Protection Act, for employee benefits, you have some other Acts such as the Factories Act and the Shops and Establishments, the Gratuity Act. For corporate governance, you have the prevention of money laundering for the Companies Act the Securities Exchange Board of India Act, the SEBI Act. So, most of these legislations get enforced through regulators who are already appointed under the particular specific statutory. So, how do you then, let's say coordinate and marry these entire statutory provisions to what we are talking about today, in the context of arbitration.

Now, there before I go into the aspect of how it all becomes later on and arbitrable dispute, because all these ESG obligations that are being followed in India today are mostly voluntary, except I guess, barring one or two, where SEBI comes into picture where there is a threshold limit for the profitability of a company what's about 1000 listed, the companies which are in the 1000 numbers, first 1000 listed companies in India. But other than that, most of these obligations are all driven by the statute. So, when an investor comes into India, an international investor, nowadays when you see and Robert brought this out that we'll be talking about the M&A context, you see a complete appendix to all the M&A contracts which go which has a complete ESG obligations.

Now, as long as it was contractual, it was easy for any of the Indian invest, Indian company to defend it by saying this is an action which has been taken by a regulator, we are still defending this action and we will eventually succeed in this, or we will probably just pay a fine and get over this. And we will give an undertaking that this doesn't get repeated again. But when it gets linked to a statute, which is in Germany, and the company which is giving you that order sitting in Germany irrespective of the fact that it is not your subsidiary, because it today also gets you, it includes an indirect supplier also, I mean, I can understand if it was restricted to a direct supply, but today it goes to the extent of even including an indirect supplier.

So, the kind of mitigation that somebody will have to do in India to ensure that everything is compliant not only with the Indian law, but complying to the extent of the German law, because, as Robert said that any NGO in India can just write to the authority in Germany, and they will take action there

against the German company. Now, take for example, a company which is selling, let's say, processing and selling tea in Germany. Now, the company which actually collects everything in India puts it there in a package proper package and sends it to Germany could be a direct supply but look at a situation where there are people at the tea gardens, who are literally plucking that tea leaf and then selling it for processing, they will probably be considered as an indirect impact of this particular Act.

And in such a situation, I mean, I don't know I mean, you're probably you're from India, you would know the ground reality more, look at the tea fields at maybe Dharamsala or Calcutta or West Bengal or the Northeast and you will find several cases of Human Rights violations happening there, including the fact that they may not probably being paid the minimum wages, in some situations. There could be sexual exploitation, where Prevention of Sexual Harassment Act is not being implemented fully, there could be cases of corruption, which are happening at the ground level there. So, there could be several such instances, which if highlighted to a German authority could actually make the German company liable.

And in turn, that company will then start reviewing its contracts with the Indian supplier. And that's where your first dispute starts. So, one is the German companies defending itself in Germany before the regulatory authority, but it also has to do something with the Indian supplier, the Indian manufacturer here, which is where the private dispute starts. So, for example, in India, we have the Companies Act, which mandates for stricter governance and control measures for larger companies, we also have the Environmental Protection Act which categorizes companies based on the pollution load factor.

Now, if there is a violation of a Company's Act in India, it is not only the company in India, which is facing any kind of an action, but the company which is let's say, it's a 60 or 50, person investee company of a German company here. So even the German company is liable for that. So, the way I look at this Act is going to have a huge impact. And if I'm, if I heard correctly, it's come, it comes into effect from 1st of January 2023, right. So, if that be the situation, I'm not too sure if whether Indian businesses or manufacturing units or supply chain are updated about it so much or educated about it so much and there is only two months, literally to say to actually start complying with everything.

While each Indian company will probably take a stand that no, no, we are compliant with the Environmental Act, we are compliant with the Companies Act, we are compliant with all the social legislations for the benefit of the employees. But there is a possibility and that's why you have such rampant litigation in India, we are literally fighting the regulators on each of these Acts every day. Be it SEBI, be it the Company's Act the MCA or be it EPF authorities' Employees Provident Fund authority, we are literally litigating them against them in courts every day.

So, the level of compliance I would say is not as much as you would expect, obviously, you would want more levels of compliances but the implication of non-compliance in India is now going to be faced somewhere outside India, which is why I say this particular German Supply Chain Act is actually a very, I believe the Indian suppliers and Indian manufacturers will consider this very harsh and onerous, because it will just take one minute for the investments to get pulled out either by terminations or risk analysis or whichever the standard liability clauses are.

Now, having said that, I think where do we see these disputes arise? I've already touched upon it, but as the GSCA which is a Supply Chain Act comes into force, we will obviously be seeing a German enterprise seeking more representations and warranties on one hand, also greater indemnities to cover their risks arising out of these obligations. So, you could possibly see a lot of termination of contracts which results in arbitration, you could see a higher indemnity not being complied with. And therefore, broad based representation and warranty claims, you will see compliance claims. And we will also see indemnity claims arising out of ESG, non-compliances such as a violation of a statutory compliance.

So, torts would probably play a very important role in terms of when it gets into an arbitration claim. So, a breach of contractual obligation imposed on an Indian supplier as a pass-through obligation, reflecting the GSCA provisions, that is provisions requiring the Indian supplier via the direct supplier or an indirect supplier to comply with these obligations, so as to enable the German company to comply with the obligations will become a huge subject matter of disputes, where there are private contracts involved. So, I think we will see in share purchase agreements disputes, we will be seeing a lot of disputes coming under the shareholders agreements.

And what is interesting is, again, I go back to the question that Kanwar you're taken, that, how do we distinguish the forum for disputing? Now, Germany is not a signatory to the foreign enforcement or foreign judgments in India. And therefore, whatever judgment gets rendered in Germany cannot be enforced in India, you will have to bring a normal civil suit and it will go through the entire recommended role of going through evidence and pleadings, et cetera. So, what is the easiest way for a German enterprise would be to enter into an arbitration claim.

Because thankfully, Germany and India both are signatories to the New York Convention, and therefore, the award which gets passed in Germany can be enforced easily, I would say, as compared to a civil litigation in India. So therefore, that would be the forum to start looking at to introduce arbitration clauses, even in your contracts, which are probably whether they don't exist, either to now, and the new contracts, obviously. So it would be, I think, one of the ways to tackle this problem, because most of the people who will be investing into India would obviously, look towards Indian companies to comply with the new Act, so to say.

Kanwar Vivswan

Thanks for that Dheeraj. There's one question that I want to pick up from what you said. You said, arbitration, of course, based on the type of contract could be a preferred mode of dispute resolution, and I'll take your views and also Roberts on this question, is whether we could think of some other forms of dispute resolution how we have in large construction contracts, these dispute resolution boards, because if there is a long supply chain, we would want it not to halt because of non-compliance at any of these levels. So, would you foresee that something like this could be put in place for supply chain disputes?

Dheeraj Nair

Yeah. I think so. I mean, whether long-term supply chain contracts, to prevent disruption, especially, a disruption would not only be a business disruption there will be a lot of employee employment disruptions as well. So, it may be a good idea to provide for a contractually agreed mechanism for resolution of such disputes as they arise, and this could be akin to a dispute resolution board in a construction contract as we see. So, the mechanism would ensure that the suspension of the

business relationship could be avoided by assisting in the formulation of some kind of remedial action to end or minimize because as I see from the Act also, there are certain remedial actions they upgraded it.

So, you have to do 1, 2, 3, 4. So, you don't have to literally run and terminate the contract at every stage, when something happens, you could approach this board which is akin to this construction board kind of authority, and there you could actually create a sort of mechanism by which you can avoid disruptions completely. So, they could also help in resolving disputes as they arise regarding interpretation of the contractual provisions also and impose such obligations on the direct suppliers, and also kind of perhaps give some kind of direction to say, okay, you have to comply with these within a time bound manner, say two months, three months, whatever the Act in Germany prescribes.

So, there is a good possibility to do that, perhaps maybe Mumbai International Arbitration Centre can probably look at setting up something around that. It could possibly have the face of an arbitration mediation kind of framework, but at the same time, it can help in not disrupting supply chain at all.

Kanwar Vivswan

Right. Thanks. Robert?

Robert Hunter

Yes, I agree. I think looking at into a crystal ball at the kind of disputes, I think supply chain disputes are going to be rather different character to the M&A disputes. And I'll concentrate for now on the supply chain. I think there are implications on the M&A side too for another day on the supply chain, taking a step up and back and looking at the basic question of risk allocation, if I were an Indian supplier or subsidiary, I'd be dividing relationships into two really, one is where I understand that I'm part of a critical supply chain, where everyone in that supply chain up to the German end producer is really dependent on that supply chain functioning, that's one situation.

The other is where it may be rather more opportunistic, where there are alternative supply chains, and where the risk is not so much, the need to keep that supply chain running. But really to avoid kind of bad faith termination or bad implications. Looking at the first one, you're in a situation where there's regulatory, inside regulatory interference, possibly regulatory orders, which have to be respected within a short timescale, at risk of the whole chain breaking down, possibly in situations, as you said, where it's actually really hard to come up with a clean bill of health right up the line. I think in those situations very definitely there needs to be a proactive approach from the beginning to try and make sure that that supply chain can be kept.

Despite interferences, possibly unexpected brought up by an NGO, there is going to be very little time to respond. And I think in that situation, we need to imagine be a bit imaginative DRBs are our model that can take him from the construction and engineering large projects sector. I think things can be learned from that what might be needed here might require some adjustment to fit a very possibly different kind of circumstance. And it seems to me that an institution like the MCIA could really fulfil a role here by listening. It's all very new territory.

And there are some existing provisions in the rules like expedited procedure, emergency arbitrator and consolidation, it may be that there needs to be an elaboration and an enrichment of those kinds of provisions very specifically for supply chains, and possibly also some kind of standing resolution. It's early days yet, but I would have thought, in a situation where everyone from the upstream to downstream has an interest in maintaining it. And taking action quickly, there is scope for institutional support of resolution processes.

Kanwar Vivswan

Thanks for that. I am now looking at my watch. And we are almost out of time. But I'll save the last one minute 20 seconds each for a takeaway question from all three of you. And my question is, what clever things the Indian businesses can do at the moment, rather than being reactive, in order to be tactical these regulations better? Starting with you, Lars, please.

Dr Lars Kutzner

Thanks, Kanwar. Very good question actually. I was once asked the same question more or less, what can be comparable to do and what maybe retire. But because the regulations are so harsh, and the demand is so immense, that of course is an investment option. What you can do is as to assess your risk on that, to see am I obligated to do things here and are obligated to do things as a supplier or as a company with a subsidiary or branch inside the EU?

What does that mean in terms of risk assessment, litigation risk assessment, arbitration assessment? Do I have suppliers or business partners that may also pose a risk to me on the other side, and that may be also transferred into the EU law scheme? So, these are the things I think you all have to do. And keep in mind you have only two-and-a-half of three years to adapt to the fields. So, it's not a lot of time. So, beware, see your risk, assess the risk, see your pitfalls of counter solutions from there. That's my take on it.

Robert Hunter

If I were a Compliance Officer or General Counsel of an Indian company, I'd be doing at least two things right now. One is, as Lars said, I would be familiarizing myself with the German One Act or asking someone to familiarize me with it. Because what is likely to be seen passed down contractually up the stream is more or less a carbon copy of the obligations in the German Act on German companies. So, the better you anticipate those obligations and start implementing due diligence and choosing your suppliers, the better, and I wouldn't wait till the first of January to be thinking about that.

The second thing I would be doing is proactively thinking about what kind of things I can offer a German enterprise; we are already drafting standard terms and codes of conduct for German companies to pass upstream. You can sit back and wait for those to hit you during a negotiation and not have time really to respond to them and have to accept them. Or you can start actually thinking about what you can reasonably offer and developing boilerplate provisions of your own that you can use to count against you.

JustAct

Kanwar Vivswan

Dheeraj, please.

Dheeraj Nair

Yeah. So, I think the question you asked is, what is the clever thing for Indian business to do? I would say the answer to that is don't get caught. But if you ask me, on a serious note, what you should be doing is, I would say, be compliant with there are literally three regulations that in India, we have to comply with, which is the environmental, the employee benefits, social legislations, and the corporate governance part of it. Those are the three of course, you have to comply with that.

But I think most importantly, I agree with what Robert said, it requires a lot of training. So, what these companies should start doing is they should start training their employees in terms of compliances. Because we see sometimes the compliances are restricted only to the top Head offices. So, they should start percolating the training down to your manufacturing processes, to the processing units, to the places where the collections and the deliverables are happening, so that each person in the supply chain is aware of the obligations and you can minimize any kind of violations to that extent. That's what I would suggest to the businesses.

Kanwar Vivswan

Thanks, Dheeraj. With that we'll come to an end of this session, which I have found very insightful, and I hope the audience did as well. Thanks to all 3 panelists for their inputs, MCIA for the opportunity and the audience for their question and participation. Thank you all. And Goodbye till next time.

Dr Lars Kutzner

Thank you.

Dheeraj Nair

Thank you. Thanks, Kanwar, Abhileen, Robert and Lars. Thank you. Bye.

Kanwar Vivswan

Bye.