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Delivering Sustainability Through Supply Contracts

WORLD SUSTAINABLE CONTRACT DAY 2022



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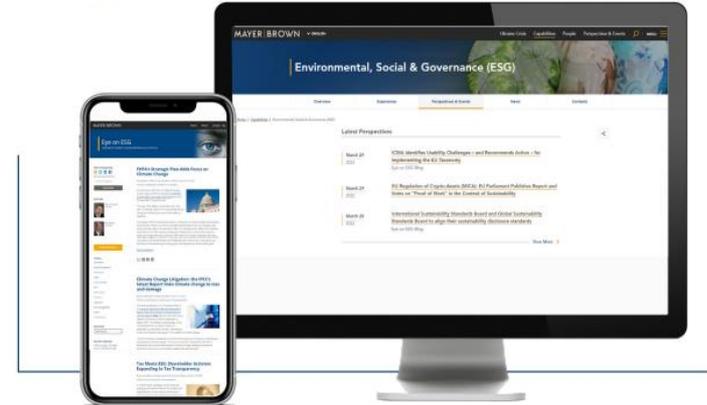
is distinctively global law firm known for its deep commercial instincts



Mayer Brown's ESG Practice

- Comprises more than **130 lawyers** in multiple disciplines, including transactional, advisory, regulatory, public policy and litigation-based practices who represent each of the jurisdictions in which we operate.
- **"Eye on ESG" blog**, launched in early 2021, has attracted, and continues to attract, high levels of interest and engagement.
- **ESG webpage** contains more information on our capabilities and experience.

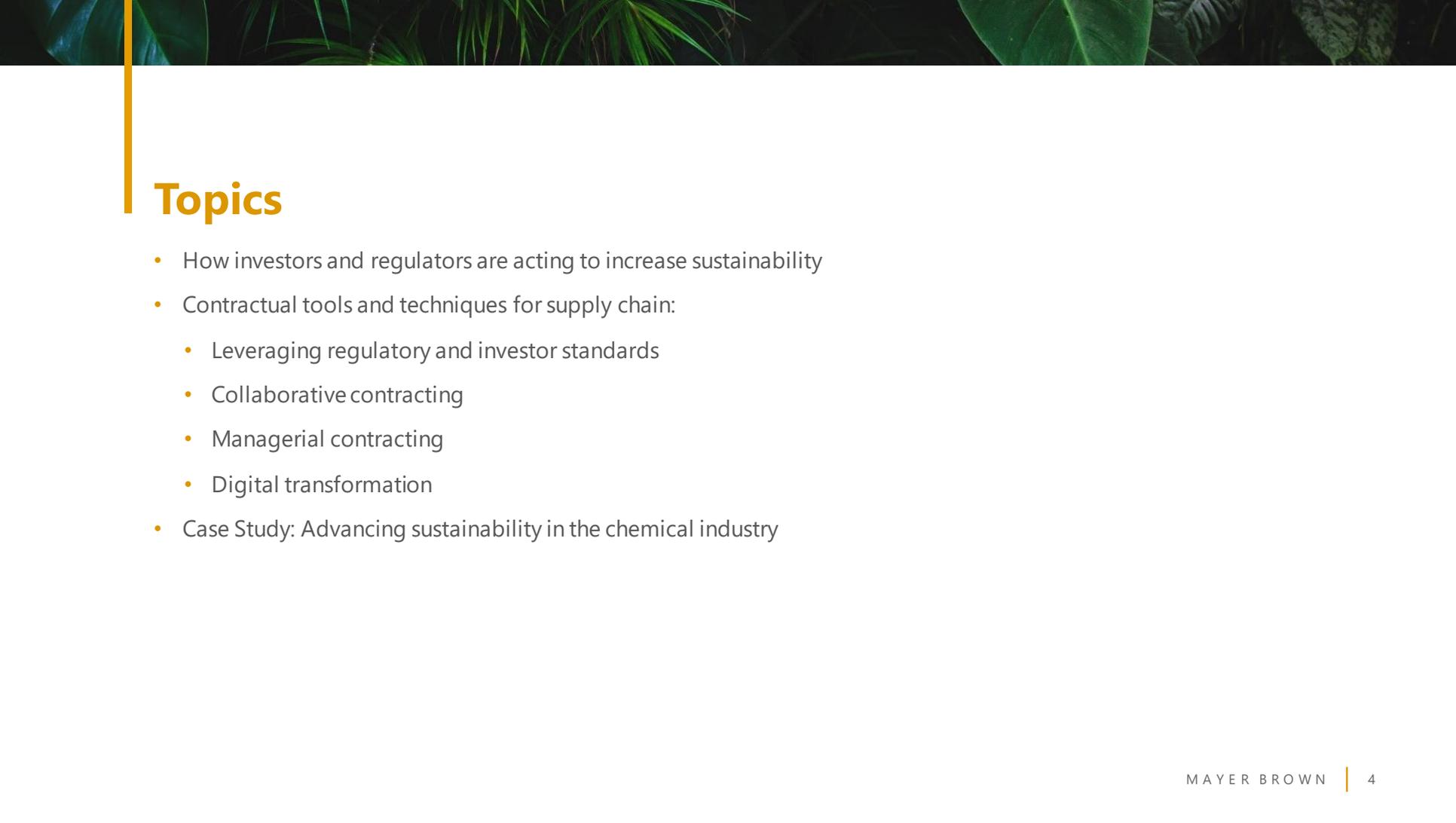
Thought Leadership



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THOUGHT LEADERSHIP PORTAL



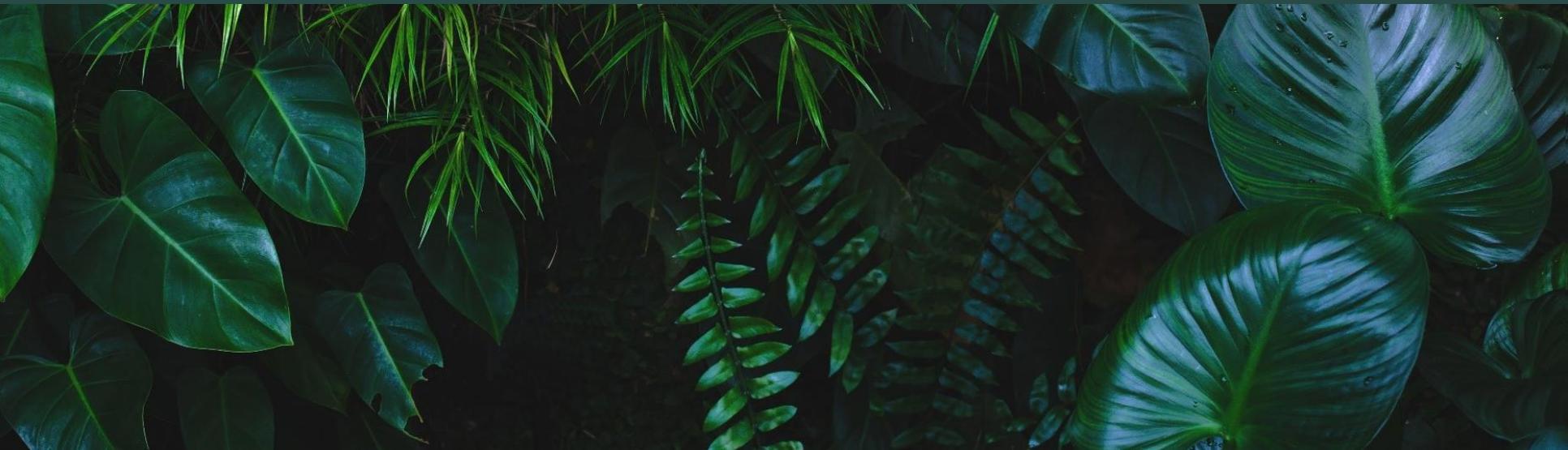
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SOCIAL AND GOVERNANCE (ESG) PAGE



Topics

- How investors and regulators are acting to increase sustainability
- Contractual tools and techniques for supply chain:
 - Leveraging regulatory and investor standards
 - Collaborative contracting
 - Managerial contracting
 - Digital transformation
- Case Study: Advancing sustainability in the chemical industry

Regulatory and Investor Pressures



The developing regulatory framework

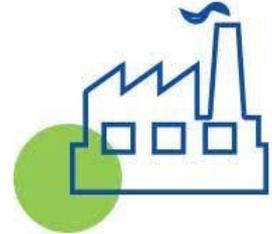
- Recent (and ongoing) legislative and regulatory developments
 - Corporate Sustainability Due Diligence Directive and Corporate Sustainability Reporting Directive
 - TCFD and TNFD
 - UK Modern Slavery Act
 - French Corporate Duty of Vigilance Law
 - German Law on Supply Chain Due Diligence
 - US proposed SEC disclosure rules
- Increased regulatory scrutiny of **supply chains** in particular



Supply chains: what needs to be addressed?

A "corporate duty to identify, prevent, mitigate and account for external harm resulting from adverse human rights and environmental impacts", including in relation to supply chains (**CSDD Directive**, Explanatory Memorandum)

- Integrate due diligence into policies (Art 5)
- Identify negative impacts (Art 6)
- Prevent potential negative impacts (Art 7) – **civil damages?**
- Removal of actual negative impacts (Art 8) – **civil damages?**
- Establish complaints procedure (Art 9)
- Monitor effectiveness (Art 10)
- Public communications (Art 11)



Case study:

German Law on Supply Chain Due Diligence – human rights risks



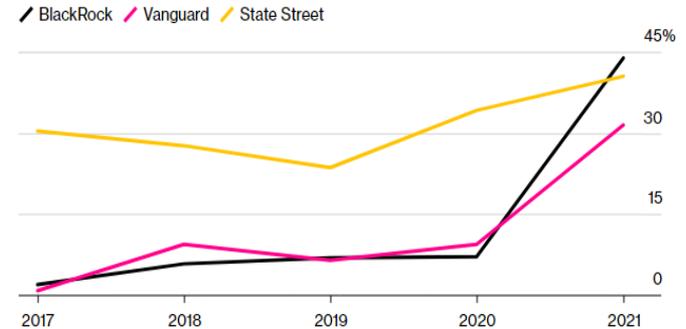
Growing investor – and other stakeholder – pressure

- United Nations **Intergovernmental Panel on Climate Change** report
- *Milieudefensie v Royal Dutch Shell*
- **UK**: undercover newspaper investigation into global fashion retailer – poor working conditions and under-payment of workers
- **France**: building materials company prosecuted for complicity in crimes against humanity?

Shareholder resolutions

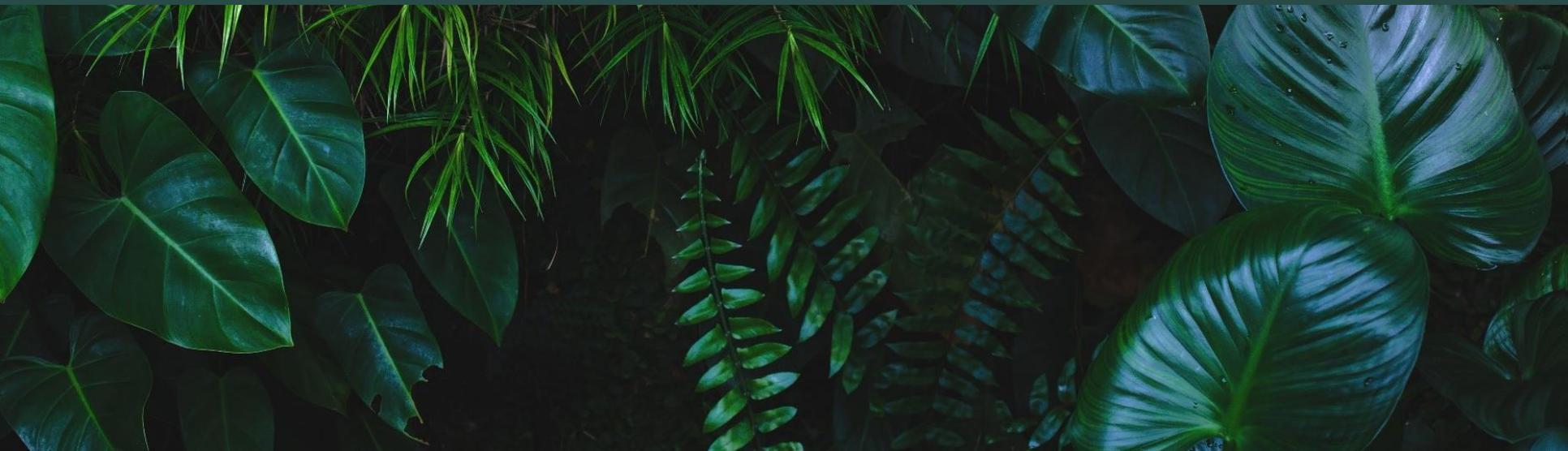
Getting On Board

The proportion of supported environmental and social proposals in the U.S. has climbed among largest money managers



Source: Insightia

Contractual Tools and Techniques for Delivering Sustainability



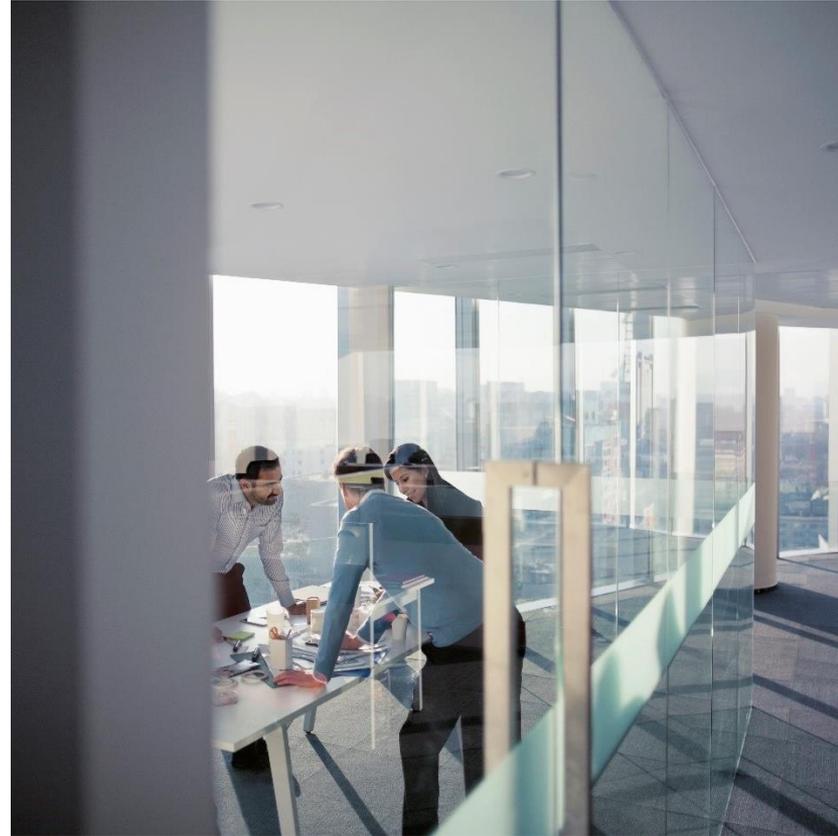
Challenges

- Supply chain contracting is optimized for delivery on time to specifications at an agreed price, not ESG
- Costs of ESG-driven changes
- Myriad stakeholders with conflicting interests
- Competing regulations
- Limited data on suppliers' ESG performance
- Need for holistic solutions



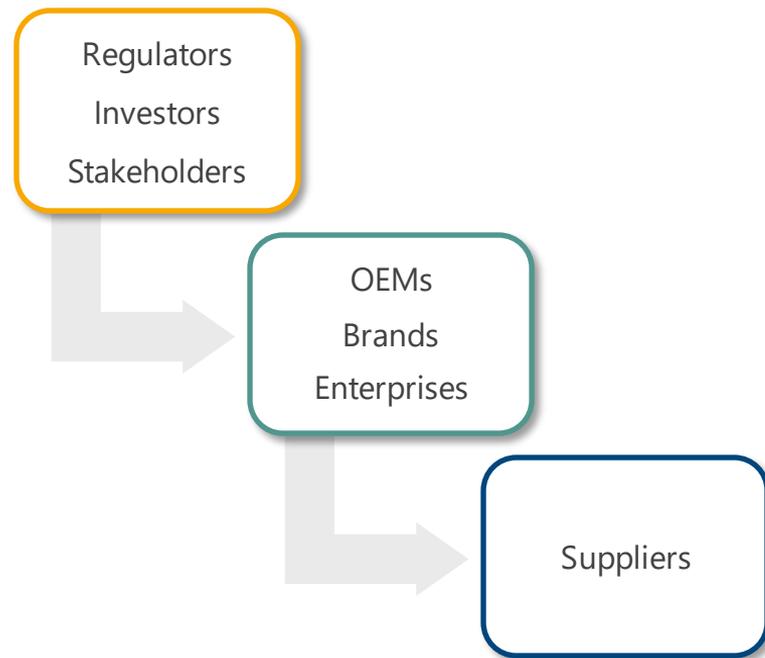
Opportunities

- Supply chains routinely deliver remarkable results when given clear objectives
- Regulators and investors are providing increasingly clear objectives
- Technical, operational, user and business stakeholders routinely collaborate to develop new requirements
- Companies can use bidding processes and analytic tools like an “internal carbon price” and scorecards
- Board-level and executive support for broad-scale change programs
- Supply chain contracts are steadily more adaptive, flexible and nuanced, allowing broad change



Leveraging accepted legal or other standards

- Leveraging standards increases credibility
- Embedding in warranties, training requirements, certification requirements and audit rights increases effectiveness
- Using a “highest global standard” approach reduces complexity
- Having a supply base acting through common standards increases efficiency
- Up front technical, operational and legal analysis reduces cost and risk
- **But:** General standards may focus at the supplier enterprise level not on (1) how the supplier produces what you buy or (2) sub-tier suppliers



Collaborative contracting

- Collaborative discussion unlocks new and more sustainable ways to supply products and services
- Aligning incentives in supply contracts facilitates transformation, including both product and production changes
- Collaborations can range from merely having a partnership mindset to collaborative supply contracts to formal joint ventures
- **But:**
 - Complex issues are raised on commitment, contribution, control and sharing of risks and rewards
 - Collaborative contracting is more complex, nuanced and novel than top-down contracting



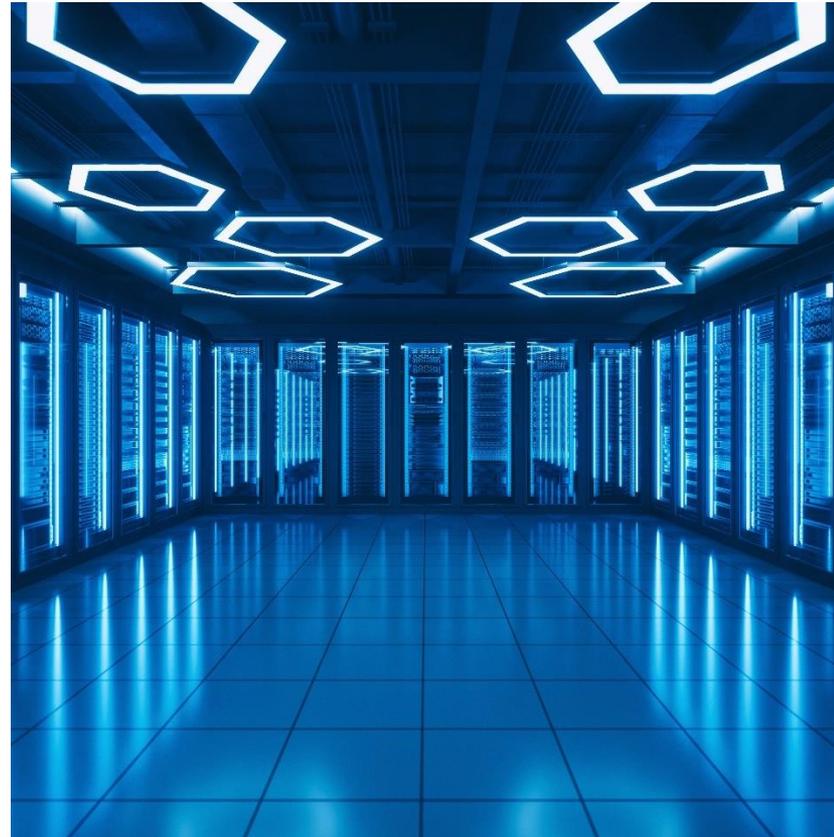
Managerial contracting

- Typically, buyers contract for delivery meeting specs for a price, the “what not the how”
- In managerial contracting, buyers contract to “manage the how” with detailed process requirements, on-site inspection rights, scorecards, incentives, relational governance structures and other management tools
- Managerial contracting is a proven process for OEMs and other integrated product manufacturers
- Managerial contracting can allow buyers to modify supplier processes based on buyer engineering to improve sustainability in demonstrable ways
- **But:** Buyers must invest more in engineering, operational management and contracting



Digitalization and digital transformation

- To measure ESG impact, you need:
 - Digitalization of sustainability by capturing sustainability data with sensors
 - Digital transformation of sustainability by replacing the currently highly-manual processes of analyzing and reporting on data with automated systems
- The benefits for suppliers include being able to provide ESG improvements credible enough to be paid for delivering them
- The benefits for buyers include lower costs for ESG enforcement and reduced risk of “greenwashing” by suppliers



Case Study: Advancing sustainability in the chemical industry



Chemical Industry

- Generally aligned to UN Global Compact and Responsible Care Principles
- Formed Together for Sustainability (TfS), a global network of 36 chemical companies that deliver the global standard for environmental, social and governance performance of chemical supply chains.
- Implemented or actively reviewing a sustainable procurement strategy or related initiatives
 - Sustainability reports generally recognize the importance of sustainability in the supply chain (particularly for key suppliers) in achieving stated sustainability goals
 - Sustainability-driven agreements (CCUS, PPAs)
 - Accounting for sustainability in “standard” agreements



Chemical Industry:

Digitalization, Digital Transformation, Link to Sustainability

Digitalization: Increases efficiency of existing processes, through **connected** computers/devices using data to make **real-time** decisions without human involvement

Digital Transformation: Creates **new** or changes existing business

Chemical industry is in the midst of digitalization and digital transformation; the pace is accelerating; progress viewed as critical.

Sustainability is a catalyst for digital transformation

Competitive advantage in **integration of sustainability and digital transformation**



Image source: The World Economic Forum

Innovative Convergence of the Building Blocks: Cloud, AI, Data

- Cloud computing
- Artificial intelligence (AI)
- Machine learning
- Bid data
- Autonomous systems
- Internet of Things (IoT)
- Robotic process automation
- Bots/robots
- Industrial Internet of Things (IIoT)
- “Smart” equipment
- Predictive analytics



Chemical Industry: Digital Initiatives

- R&D (accelerate chemical discovery, lower research costs, optimize testing)
- Supply Chain (Industry 4.0; end-to-end transparency, inventory reduction)
- Manufacturing (improving speed of throughput; enhancing quality; process automation)
- Waste reduction (analysis of raw material costs; demand forecasting)
- Safety and compliance (remote monitoring and predictive maintenance)

DIGITAL TRANSFORMATION

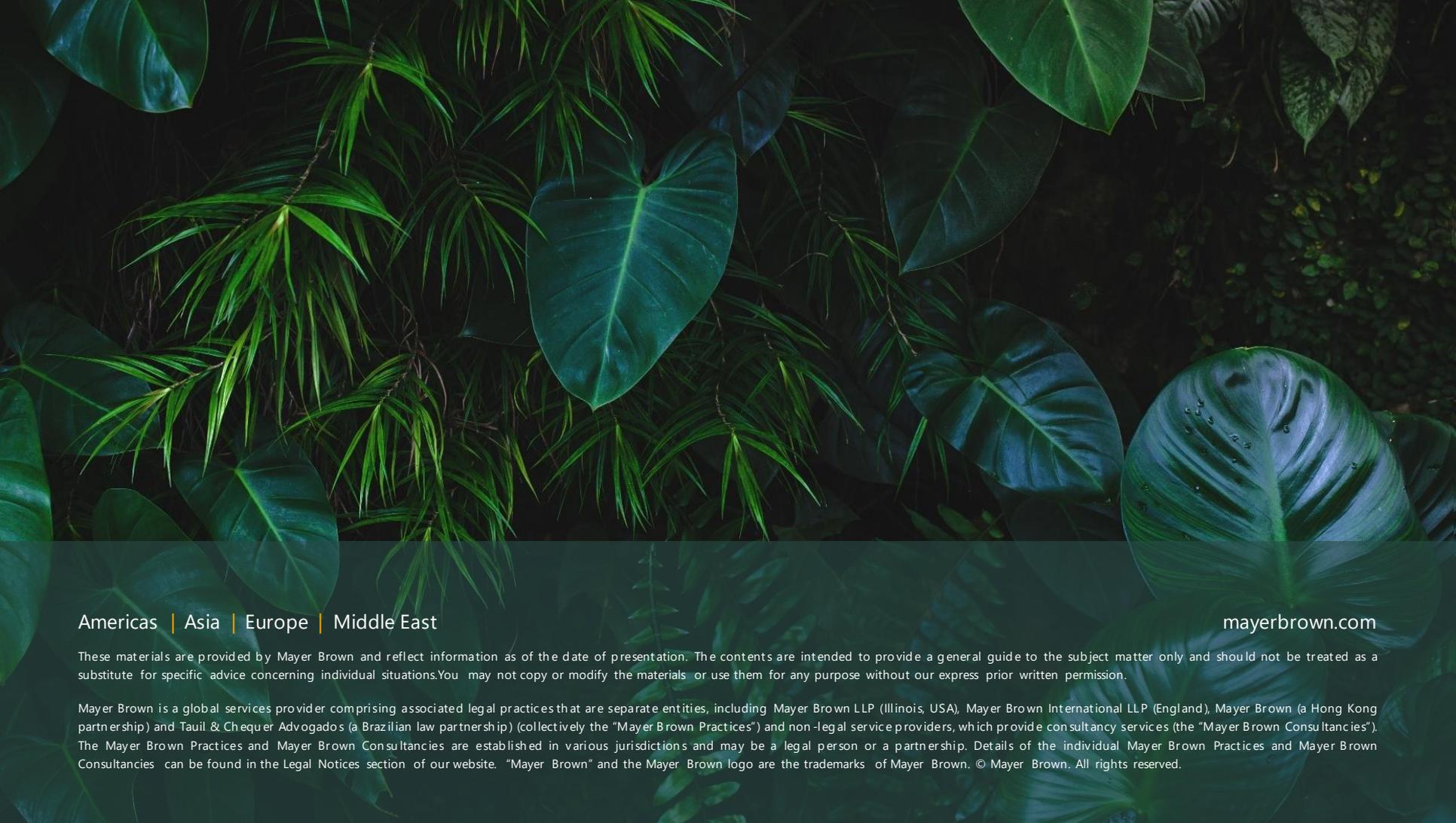


Image source: Precognize

Conclusion

- Efforts by regulators and investors are clarifying sustainability objectives for buyers
- Achieving those objectives will require buyers to go beyond traditional sourcing approaches
- Success will demand comprehensive, holistic approaches informed by extensive analysis and planning





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