

Greening your supply chain

Many businesses want to turn the impact of COVID-19 on their supply chains into an opportunity to improve efficiency and increase margins. They can do so by integrating sustainable environmental processes into the traditional supply chain from the point of product design, material sourcing and selection, to manufacturing and production, operation and end-of-life management, and even investment. This paper sets out the key steps and considerations suppliers, buyers and investors could take to achieve a green supply chain. In this context, it is important to note that the definition of “green” both in relation to supply chains themselves and more generally, has become broader over recent years. Being “green” no longer focusses entirely on environmental impact but also encompasses economic prosperity, environmental quality and social justice.

Suppliers

Suppliers can adopt community or industry supplier standards in relation to Environmental, Social and Corporate Governance (ESG). A commitment from the top and a multi-disciplinary diverse team are key to achieving a green supply chain.

A supplier is also likely to have its own ESG *code of conduct*. Make partners in the chain aware of, and sign up to, this code of conduct, as part of the onboarding process and insist on transparency.

Conduct an audit of your own practices, and of all lower tier suppliers in your supply chain, considering issues such as:

- Does each tier use raw materials that are *extracted sustainably and from ethical sources*?
- At each tier, does supply meet demand in order to *reduce overproduction*?
- Are waste materials used *resourcefully*? Can they be sold and used to create a different product?
- How are products *treated* when they reach the end of their working life? Could they be returned and broken down for parts or materials?
- Are warehouses designed as *efficiently* as possible, both in terms of footprint and “non-green” overheads?

Key considerations

- **Suppliers** can adopt community or industry ESG supplier standards. A commitment from the top and a multi-disciplinary diverse team are key to achieving a green supply chain. A supplier can also consider implementing its own ESG code of conduct and can make partners in its supply chain aware of, and sign up to, this code of conduct.
- **Buyers** can identify drivers of waste and work with suppliers to set short and long-term goals. Buyers can also conduct regular reviews of their existing supply chain contracts or create new incentives and opportunities during procurement.
- **Investors** can introduce environmental obligations in investment documentation. Investors could also use equity ratchet terms in investment documents to financially incentivise management teams to meet targets which are linked to climate change and environmental issues.

- How are raw materials being *transported*? Can suppliers *work together* to ensure that transport containers are fully used reducing the total amount of transportation and energy required? Does transport ever *travel empty*? Is there anything that could be done to eliminate this?
- Could there be more *sustainable* or less packaging on the products – does the current packaging fail to keep products adequately protected from breakage or spoiling? Suppliers should keep in mind that from April 2022, a new tax will be applied to plastic packaging produced in or imported into the UK that does not contain at least 30% recycled plastic. Focussing on sustainability in packaging could therefore also reduce suppliers' tax outputs.
- Are workers being *paid fairly*, and working in *hygienic and safe environments* that meet the industry standards?

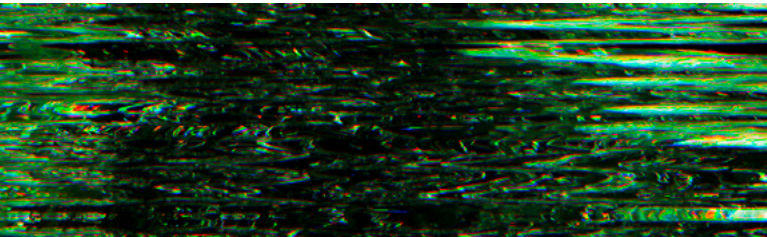
Consider if any of the below are suitable and can be implemented to reduce your level of exposure and risk:

- *Encourage collaboration* with lower tier suppliers to check in with their own suppliers. You could set group targets for the supply chain which can only be achieved through collective efforts.
- Could *technology*, such as *artificial intelligence*, be deployed at any level of the supply chain to analyse data and propose a more sustainable practice?
- Could *discounts* be offered to local customers, to encourage the use of *local* raw materials, reducing the overall need for travel time?
- Suppliers could *impose restrictive covenants*, for example to require a third party to restrict trade with sources that are not approved as "green". These would need to be drafted carefully to ensure they are legally compliant.
- Review your current standard form contracts and consider including *termination rights* in the event that the other party is unable to maintain the requisite ESG standards.

Buyers

Buyers can identify drivers of waste and work with suppliers to set short and long-term goals. Buyers can conduct regular reviews of their existing supply chain contracts or create new incentives and opportunities during procurement. Buyers must make sure their contracts enable them to measure suppliers' performance to ensure progress towards long-term goals.

Buyers can also:

- Conduct a review to *identify barriers* and prioritise which areas you need to focus on and the steps likely to achieve progress. Consider what has previously hindered or prevented greening of your supply chain. Is it lack of choice of suppliers or limited supply of raw materials? Is it the state of technology, lack of knowledge of the alternatives, or cultural resistance (which may be reflected or embedded in the standard terms and agreements)? Is there anything to learn from your competitors in this area?
 - *Know your supplier* – By engaging with your suppliers, you can understand what ESG criteria are in place and their current challenges and opportunities. Are there suppliers who are not transparent about their ESG obligations or practices (in which case, look to your contracts to see if there are any information or document rights you can rely on)? Are they demonstrating commitment to innovation and sustainability?
 - *Consider incentives and create competition* – What can you offer your supplier to incentivise them to green their supply chain? For example, Requests for Proposals could include criteria requiring ESG-compliance and / or weight them more heavily.
 - *Require commitment and compliance* – Place ESG or equivalent criteria at the heart of tenders and subsequently, contracts, and include compliance and enforcement measures. Require suppliers to demonstrate, on an ongoing basis, that their practices and processes are ESG compliant. Consider contractual mechanisms to restrict the supplier's ability to change elements or aspects of its supply chain without notifying or consulting the buyer, and a mechanism to agree changes of elements or aspects of the supply chain.
 - *Take a holistic view* – Do you have the right individuals in your procurement and purchase teams? What training, support, and motivation do they need to understand, and maximise, their role in influencing the greening process? What relationships and networks do they need to build?
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Investors

Investors can assist with greening the supply chain by introducing various environmental obligations in investment documentation, for example, requiring an investee company to:

- Provide information regarding a wide range of climate-related issues at the due diligence stage.
- Setting a net zero target and incorporating the plan to deliver such target into the contractual obligations.
- Reporting annually on sustainability and the climate risks and opportunities to the company.
- Create KPIs to measure the company's impact of its operations and goods / services.
- Use 100% renewable energy at all offices / sites.

Investors could also use equity ratchet terms in investment documents to financially incentivise management teams to meet targets which are linked to climate change and environmental issues.

Green finance could be mobilised by making the qualifying criteria for receiving finance conditional on setting a net zero target aligned with the UK Net Zero Policy.

Warranties and undertakings in agreements could be extended to require full and specific disclosure of the company's position and performance by reference to specified metrics (such as science based or net zero targets) and continuing disclosure regarding any deficiencies identified with a view to continuous improvement.

Potential areas for dispute

When moving towards an overall greener supply chain, suppliers, buyers and investors should take care to avoid potential disputes:

- Make changes to the supply chain in accordance with contractual obligations and seek approval from stakeholders, where necessary.
- There may be a difference in opinion between shareholders who are focussed on financial goals, and those focussed on sustainable changes. Companies should be aware of possible shareholder actions.
- A disgruntled company who is not meeting their KPIs may look to start a dispute to protect itself. Be clear as to how you are approaching their KPI framework and reviews to avoid any potential for disagreement in this area.

Conclusion

Placing ESG and sustainability at the core of your contracts, investment documentation and shareholder agreements and then working with your partners in the supply chain to meet those obligations is essential to achieving a green and efficient supply chain. Even small green changes now can have a significant impact overall and lead to long-term gains for all in the supply chain.

Key contacts



Ben Trust

Partner, Disputes

T +44 20 7524 6234

E ben.trust@cms-cmno.com



Hannah Curtis

Partner, Commercial

T +44 20 7367 3726

E hannah.curtis@cms-cmno.com



Kushal Gandhi

Partner, Disputes

T +44 20 7367 2664

E kushal.gandhi@cms-cmno.com



Gowri Chandrashekar

Associate, Disputes

T +44 20 7367 3146

E gowri.chandrashekar@cms-cmno.com



Louise Pearce

Associate, Disputes

T +44 20 7367 3596

E louise.pearce@cms-cmno.com



Laura Swithinbank

Associate, Environment,
Health & Safety

T +44 20 7524 6031

E laura.swithinbank@cms-cmno.com