

CLIENT ALERT

# One Step Closer to the EU Corporate Sustainability Due Diligence Directive

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The European Union has recently reached a provisional agreement on the Corporate Sustainability Due Diligence Directive ("**CSDDD**"), a highly anticipated legislation aimed at enhancing environmental and human rights protection within the EU and globally.

The CSDDD places substantial responsibilities on large EU and Non-EU companies, requiring them to assess and address actual and potential adverse impacts on the environment and human rights throughout their business operations, including those of their subsidiaries and business partners.

## Key Aspects of the CSDDD

### Companies within Scope

The CSDDD will apply to the following entities ("**In-Scope Companies**"):

- (1) Large EU companies with more than 500 employees (on average) and a net global turnover exceeding €150 million;
- (2) ultimate parent companies of large EU companies for which consolidated annual financial statements have been or should have been adopted;

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- (3) companies that entered into or are the ultimate parent company of a group that entered into certain franchising or licensing agreements in the EU, where the royalties amount to more than €7.5 million, and the company had or is the ultimate parent company of a group that had a net worldwide turnover of more than €40 million;
- (4) EU companies that generate turnover of at least €20 million in predefined "high risk" areas and have more than 250 employees (on average) and a turnover of more than €40 million. The high risk sectors include textiles, clothes and footwear, agriculture (including forestry and fisheries), food and beverage production, and construction, as well as extraction and wholesale trade of mineral resources or manufacturing of related products.
- (5) Non-EU companies that generate over €150 million in net turnover within the EU<sup>1</sup>.

Small and medium-sized enterprises ("**SMEs**") are not within the scope of the CSDDD. However, many smaller companies will find themselves affected as a result of the due diligence obligations described below.

The financial services sector is initially excluded (with exceptions regarding Climate Transition Plans as described below). However, a review clause allows for potential subsequent inclusion. The EU Commission will submit a report on the necessity to lay down additional sustainability due diligence requirements tailored to regulated financial undertakings "at the earliest possible opportunity" but no later than two years after the CSDDD enters into force.

### Due Diligence Obligations of In-Scope Companies

In-Scope Companies will need to conduct due diligence to identify and assess actual and potential adverse impacts on the environment and human rights throughout their business, including throughout their supply chains, for both upstream and downstream business partners. In contrast to other supply chain laws, this obligation might not be limited to direct business partners and might also include indirect business partners, provided the business relationship is sufficiently established.

Where adverse impacts are identified, In-Scope Companies will have to take appropriate measures to prevent or mitigate potential adverse impacts and take steps to end, minimise or remedy those impacts. An In-Scope Company might use actual or potential adverse impacts as a basis on which to terminate a business relationship or to not award contracts.

The CSDDD covers several environmental and human rights prohibitions, such as pollution, deforestation, excessive water consumption and damage to biodiversity.

Annex I to the CSDDD will contain a list of what will be considered to qualify as impacts on human rights and the environment. In relation to human rights, this will include legislation relating to child or forced labour, modern slavery, labor exploitation and specific UN Conventions such as the International Covenant on Civil and Political Rights, the International Covenant on Economic, Social and Cultural Rights and the Convention on the Rights of the Child.

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<sup>1</sup> To ensure clarity and to aid non-EU companies in identifying their obligations, the European Commission will publish a list of non-EU companies that are within [the] scope of the CSDDD. In addition non-EU companies with turnover in high[-] risk sectors may also be in scope but this is to be confirmed once the final text is published and agreed.

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In relation to environmental impacts, Annex I will include air or water pollution, harmful emissions, excessive water consumption or other impacts on natural resources.

In-Scope Companies will be required to publicly communicate and regularly monitor the effectiveness of their due diligence procedures. In-Scope Companies will need to establish a complaint mechanism, which must be accessible to individuals throughout the supply chain.

### Climate Transition Plan

In-Scope Companies (in this respect, including the financial sector) will be required to develop and publish plans to align their business models with the goal of limiting global warming to 1.5°C in accord with the Paris Agreement on climate change.

### Civil Liability and Penalties

A person affected by adverse impacts of In-Scope Companies (an "**Affected Person**") will be able to bring a civil claim within a five-year limitation period. Claims may be brought by trade unions or civil society organizations on behalf of an Affected Person. There are also specific limits on evidence disclosure, injunctive measures, and recovery of costs for claimants.

National authorities in member states may bring enforcement action against non-compliant companies. They may levy fines, totaling at least 5% of the company's turnover<sup>2</sup> and/or face injunctive measures. Due to the possibility of naming and shaming by the competent authorities, non-compliant companies could further be exposed to increased reputational risks.

### Harmonization throughout all Member States

In order to avoid distortion of competition due to differently structured due diligence obligations, the EU is striving for harmonization in the area of supply chain laws. However, the provisions of the CSDDD go well beyond, *inter alia*, the German Supply Chain Due Diligence Act (LkSG), which has been in force since January 2023 and is considered internationally to be one of the first of its kind. The obligations of the CSDDD will have to be codified into law by each member state. In-Scope Companies will inevitably be affected by diverse legal regimes in the countries where they do business and will have to factor this into their due diligence processes.

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<sup>2</sup> Subject to the final text being agreed.

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### *The Impact on Future Businesses – Public Procurement*

Compliance with CSDDD may become a criterion for awarding public contracts and concessions. It will therefore be important for companies to keep up to date with the CSDDD requirements.

### *Comparison to the CSRD*

Whilst both the Corporate Sustainability Reporting Directive (Directive (EU) 2022/2464 – ("**CSRD**")) and the CSDDD support the ESG-focused objectives of the European Green Deal, they each adopt a slightly different approach. As set out in our October 12, 2023 client alert entitled *Sustainability Reporting Under the CSRD for EU and non-EU Companies*<sup>3</sup>, the CSRD creates reporting and disclosure obligations that force In-Scope Companies to be transparent about the impact of their business on sustainability matters relating to people and the environment. This differs from the CSDDD, which imposes obligations that require In-Scope Companies to take active responsibility to eradicate or mitigate identified adverse impacts their business has on the environment or human rights.

### **Next Steps**

The provisional agreement on the CSDDD will need to be finalized, published and formally adopted by both the Council of the EU and the European Parliament before entering into force. The transposition of the agreement into the final legal text will involve further technical negotiations and therefore might affect the details of how the CSDDD applies. A final version is expected, at the earliest, by Q2 2024. Once the CSDDD enters into force, EU member states will have a period of two years to integrate the provisions of the CSDDD into their national laws, whereupon EU In-Scope Companies must comply. The CSDDD's requirements are expected to apply to the largest EU companies (1,000 or more employees) mid-2027 and one year later to large EU companies (500 or more employees). The provisions will not apply to Non-EU companies in scope until three years from when the CSDDD comes into effect (i.e 2027 at the earliest).

In-Scope Companies should start to plan for compliance with the due diligence requirements of both any applicable national laws and those of the CSDDD to align their policies and procedures accordingly.

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<sup>3</sup> Please link to the CSRD alert ([https://www.willkie.com/-/media/files/publications/2023/10/sustainability\\_reporting\\_under\\_the\\_csrd\\_for\\_eu\\_and\\_non-eu\\_companies.pdf](https://www.willkie.com/-/media/files/publications/2023/10/sustainability_reporting_under_the_csrd_for_eu_and_non-eu_companies.pdf)).

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## One Step Closer to the EU Corporate Sustainability Due Diligence Directive

If you have any questions regarding this client alert, please contact the following attorneys or the Willkie attorney with whom you regularly work.

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