

CLIENT ALERT

EU Council adopts EU Corporate Sustainability Due Diligence Directive and sets future direction of the Single European Market (SEM)

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On March 15, 2024, the member states of the European Union voted in favour of the significantly revised compromise proposal submitted by the Belgian Council Presidency on the Corporate Sustainability Due Diligence Directive (“**CSDDD**”), a highly anticipated legislation aimed at enhancing environmental and human rights protections within the EU and globally. The revised CSDDD has now been finally adopted by the EU Council on May 24, 2024. This is the final step in the legislative procedure. The EU member states must now transpose the directive into national law.

As communicated in our previous CSDDD client alert from February 2024¹, 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. However, the recent compromise led to significant changes, in particular a substantial reduction of companies in scope of the revised CSDDD as further detailed below.

¹ [https://www.willkie.com/-/media/files/publications/2024/02/one step closer to the eu corporate sustainability due diligence directive.pdf](https://www.willkie.com/-/media/files/publications/2024/02/one%20step%20closer%20to%20the%20eu%20corporate%20sustainability%20due%20diligence%20directive.pdf).

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Key Aspects of the CSDDD

Companies within Scope (“In-Scope Companies”)

From 2027, the CSDDD’s requirements are expected to apply to:

- 1) the largest EU companies (5,000 or more employees and a net global turnover exceeding €1,500 million); and
- 2) non-EU companies with a net turnover in the EU exceeding €1,500 million.

From 2028, the CSDDD will apply to:

- 1) large EU companies (3,000 or more employees and a net global turnover exceeding €900 million); and
- 2) non-EU companies with a net turnover in the EU exceeding €900 million.

From 2029, the CSDDD will eventually apply to the following entities:

- 1) Large EU companies with more than 1,000 employees (on average) and a net global turnover exceeding €450 million;
- 2) ultimate parent companies of large EU companies with more than 1,000 employees (on average) and a net global turnover exceeding €450 million;
- 3) non-EU companies that generate over €450 million in net turnover within the EU;
- 4) ultimate parent companies of a group with a net turnover in the EU exceeding €450 million;
- 5) 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 €22.5 million, and the company had or is the ultimate parent company of a group that had a net worldwide turnover of more than €80 million².

Exemptions apply for (i) ultimate parent companies that are non-operational, (ii) companies that cease to meet the applicable criteria for each of the last two relevant financial years, and (iii) alternative investment funds (AIFs) and undertakings for collective investment in transferable securities (UCITS).

² 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 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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Companies operating in so called “high-risk” sectors that were originally in scope have been deleted from the current draft. The Commission will issue guidelines for specific sectors on how to fulfil the due diligence obligations and will also report within six years on the implementation of the CSDDD, specifically to address (among other things) whether a sector-specific approach is warranted for high-risk sectors.

Small and medium-sized enterprises (“SMEs”) are not in 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 of their operations on the environment and human rights throughout their business, including throughout their supply chains, 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 that the business relationship is sufficiently established. Particularly noteworthy is the expressly risk-based approach. Companies are explicitly required to prioritise their due diligence efforts based on the severity and likelihood of negative impacts. However, there will be certain exceptions for product disposal and export permits for dual-use goods and weaponry.

Although regulated financial undertakings are only subject to due diligence obligations for the upstream part of their chain of activities, the specificities of financial services as well as the Organisation for Economic Cooperation and Development (“OECD”) Guidelines for Multinational Enterprises provide indications of the types of measures that are appropriate and effective for financial undertakings to take in due diligence processes. Regulated financial undertakings are expected to consider adverse impacts and to use their so-called ‘leverage’ to influence companies. The exercise of shareholders’ rights can be a way to exercise leverage.

The due diligence obligations have been expanded and more closely resemble the requirements in the OECD Guidelines for Multinational Enterprises on Responsible Business Conduct. 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 either 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 not to award contracts and is obliged to prioritise its decision-making according to the strength and probability of those impacts.

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The newly implemented “group clause” allows In-Scope Companies to fulfil most of their due diligence obligations at group level.

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 international human rights and environmental agreements and conventions, the violation of which will be considered to qualify as adverse impacts on human rights and the environment. In relation to human rights, this will include legislation relating to child or forced labour, modern slavery, labour 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.

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 and other stakeholders.

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. If the company develops or is included in a transition plan for climate change mitigation in accordance with Art. 19a, 29a or 40a of the EU Accounting Directive and the first set of European Sustainability Reporting Standards, the company's obligation is deemed satisfied.

Civil Liability and Penalties

Persons 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 organisations on behalf of an Affected Person. There are also specific limits on evidence disclosure, injunctive measures, and recovery of costs for claimants. In order to prevent overcompensation, In-Scope Companies will only be liable if the relevant provision is aimed at protecting individuals. However, there is the opportunity for stakeholders (e.g. trade unions and NGOs) to be authorised to enforce the rights of victims in court, which might lead the company to disclose evidence in a discovery-like procedure. Furthermore, companies can be held liable even if they use third-party verification or contractual clauses to support implementation of due diligence obligations or participate in industry or multi-stakeholder initiatives. However, personal liability regarding

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directors' duties for failing to take into account the consequences of their decisions for sustainability matters has been removed from the final text of the CSDDD.

National authorities in member states may bring enforcement action against non-compliant companies. They may levy fines, totalling at least 5% of the company's turnover 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.

Harmonisation throughout All Member States

In order to avoid distortion of competition due to differently structured due diligence obligations, the EU is striving for harmonisation 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.

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 stay 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*³, the CSRD creates reporting and disclosure obligations that force its 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 that their business has on the environment or human rights.

Next Steps

Following the Council's approval of the European Parliament's position, the legislative act has now been formally adopted. The provisional agreement on the CSDDD will be published in the Official Journal of the European Union and will enter into force 20 days after the official publication.

³ 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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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 (5,000 or more employees and a net global turnover exceeding €1,500 million) and Non-EU companies with a net turnover in the EU exceeding €1,500 million from 2027 and one year later to large EU companies (3,000 or more employees and a net global turnover exceeding €900 million) and Non-EU companies with a net turnover in the EU exceeding €900 million. For the remaining companies, the CSDDD's requirements are expected to apply from 2029.

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 in order to align their policies and procedures accordingly.

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